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KSA HEALTHCARE SECTOR – INITIATION OF COVERAGE

Solid secular theme underway

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Saudi Arabia – Healthcare

Solid secular theme underway

- **Strong underlying fundamentals:** Saudi Arabia's healthcare services sector offers an attractive investment opportunity driven by strong macroeconomic factors. While favorable demographics (population of 29.2mn), rising income levels (GDP per capita at USD 23,599 in 2011, +24% YoY) and increasing incidences of lifestyle diseases (diabetes prevalence at 15%) in the Kingdom are expected to drive demand, deficient supply (11 to 12,000 additional beds required by 2016E), presents an opportunity for the private players. Supported by the government's initiatives to encourage private participation (e.g. interest free funding facility of up to SAR 200mn for private hospital projects), Mouwasat Medical Services Company (Tadawul: 4002, 'Mouwasat'), Dallah Healthcare Holding Company (Tadawul: 4004, 'Dallah') and National Medical Care Company (Tadawul: 4005, 'Care') are well positioned to take on a larger role.
- **Mouwasat (Buy, TP SAR 102/share) is our top pick in the sector:** In this note, we initiate coverage on the three listed healthcare names: Mouwasat, Dallah and Care. Given the secular growth drivers and respective positioning, while we like the business profiles of all the listed names, we prefer Mouwasat (over Care and Dallah) which we rate as Buy (TP SAR 102/share) and remains our top pick in the sector. Admittedly, valuation (2014E P/E of 18.2x) may not look overtly cheap; nonetheless, we believe a high quality mature play with a proven execution record such as Mouwasat deserves a premium valuation. With its presence in both the Eastern and Western regions (particularly in Riyadh / in 2014 and Madinah that house ca.32% of KSA's population) the company not only offers diversification and scale (largest among the listed peers) benefits, it also boasts of a superior execution profile which is well reflected in high Operating Margins (2013E 23.7%) that are ca. 600bps higher than its peer group. Furthermore, with earnings set to grow at ca.19% CAGR (SFC est. 2013-15E) in the next couple of years, the growth profile looks robust and should provide further valuation support. On the other hand, while we like the potential capacity expansion story of Dallah (TP SAR 70/share) and margin expansion story of Care (TP SAR 56/share), we acknowledge execution risks and as such remain on the sidelines for now as we wait for proof of superior execution.
- **Rich sector valuation is justified by robust growth:** The KSA healthcare sector trades at 2014E P/E of 18.3x (6% premium to MEA peers and at 5% discount to global peers) which does not look cheap at a first glance. In our view, potentially robust earnings growth makes up for the rich valuation. At a sector level, we expect healthcare earnings to grow at ca.25% CAGR between 2013-15E (vs. 8.8% between 2011-13) compared to earnings growth of 15% for the Tadawul. While forthcoming capacity expansion should drive volume growth, we think economies of scale are likely to lead to solid margin expansion (297bps between 2013-15E) primarily led by Care/ Dallah as they strive to catch up with Mouwasat on the margin front.
- **Favorable capital markets environment is likely to provide valuation support:** Given the government's strong emphasis on increasing private sector participation, private providers are vying to be part of the Kingdom's healthcare sector story which is well reflected in their capacity expansion plans. While recent listings of Dallah (2012) and Care (2013) suggest that the private providers are willing to tap into the capital markets for funding their capacity expansion initiatives, given the solid price performances of the three listed entities since IPO (Mouwasat +289%, Dallah +67% and Care +100% from allotted prices), we believe solid investor interest exists for the KSA healthcare names. Furthermore, in our view, forthcoming listings of Sulaiman Al-Habib Medical Group and Almana General Hospitals in 2014 could not only act as a catalyst for increased investor appetite for the sector, but it could also provide valuation support for the existing listed names.

Ratings Summary

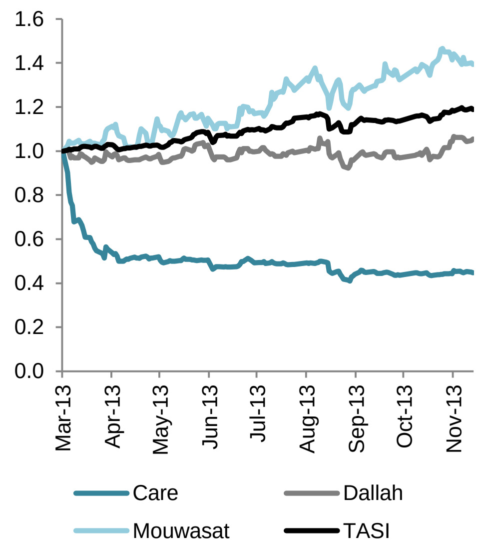
Company	Rating	Price	Target Price	Upside
Mouwasat	Buy	86.0	102	18.6%
Dallah	Hold	67.5	70	3.7%
Care	Hold	54.5	56	2.8%

Prices as of November 25, 2013

Valuation Summary 2014E at current market prices

Company	P/E (x)	EV/ EBITDA (x)	Dividend yield (%)
Mouwasat	18.2	14.2	2.7
Dallah	18.5	13.7	2.7
Care	18.0	14.3	3.4

Healthcare Stock Prices versus TASI



Source: Bloomberg

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Healthcare Services Sector

Saudi Arabia's healthcare services sector offers an attractive investment opportunity. Favorable demographics (2012 population base: 29.2mn, YoY growth: +2.9%, compounded average growth rate (CAGR) of 3.0% for the period 2000 to 2012), rising income levels (annual GDP per capita at USD 23,599 in 2011, +24% YoY), increasing incidences of 'lifestyle' diseases (e.g. diabetes prevalence at 15%) and a growing awareness of 'wellness' concepts (driven by higher literacy levels and urbanization) are expected to drive demand for the provision of quality healthcare services.

On the other hand, deficient supply (bed density at 2.2 vs. World average of 3.0 per 1000 people) presents an opportunity for the private players. While the government, via the Ministry of Health (MOH), remains the dominant economic agent in the sector (69% of hospitals and 77% of bed capacity), the opportunity for the private sector is further supported by the Government's initiatives to encourage the former's participation in the sector. The interest free funding facility for private hospitals (applicable cap of SAR 200mn) is an example of such an initiative. Rising Inpatient (2009: 3.0mn) and Outpatient (2009: 131.2mn) volumes are expected to boost capacity utilization levels of the domestic healthcare providers; whereas better pricing (particularly from the insured patients segment) will aid margins.

Listed Private Players

The Saudi healthcare services sector has three listed private players - Mouwasat Medical Services Company (Tadawul: 4002, 'Mouwasat'), Dallah Healthcare Holding Company (Tadawul: 4004, 'Dallah') and National Medical Care Company (4005, 'Care'). Together the three companies, with a total bed capacity of 1,391 beds across the Kingdom, complement the government owned centers in catering to the demand for general as well as specialized healthcare services. At the end of 3Q 2013, the 3 listed healthcare companies had total Revenues of SAR 513mn with a total market capitalization of SAR 9.4bn (1.3% of TASI's total free-float market capitalization).

Mouwasat was the first company to tap the capital markets in the Kingdom when it raised SAR 330mn through its Initial Public Offering (IPO) on September 2, 2009. At the time, the issue was oversubscribed 4.7 times reflecting investor appetite for healthcare services stocks. Dallah was the second company to have listed in the Saudi healthcare services space raising SAR 539.6mn on December 17, 2012 with the issue oversubscribed 3.1 times. Care was recently listed (on March 13, 2013) and raised SAR 364.5mn (issue oversubscribed 7.1 times).

Fig. 1: KSA Healthcare Services Sector – Returns Summary

	Mouwasat	TASI	Dallah	TASI	Care	TASI
Since IPO	289%	49%	67%	21%	100%	19%
Year-to-date (YTD)	60%	23%	3%	23%	100%*	23%
3Q 2013	19%	6%	1%	6%	-6%	6%

Sources: *Tadawul, Bloomberg and Zawya*

Note: **YTD returns same as since IPO*

Fig. 2: KSA - Healthcare Services Sector Outlook, 2014 &15E

	Revenues (SAR mn)		Operating Margin (%)		Net Profit (SAR mn)		Dividends (per share)	
	2014E	**2015E**	**2014E**	**2015E**	**2014E**	**2015E**	**2014E**	**2015E**
Mouwasat	1,103	1,257	23.8	23.8	236	269	2.36	2.69
Dallah	857	1,052	21.3	22.7	172	224	1.82	2.38
Care	674	757	20.0	22.2	136	169	1.87	2.32

Source: Saudi Fransi Capital

Mouwasat (Buy, TP SAR 102/share) – Top Pick

Mouwasat is our top pick in the KSA healthcare services sector. The company appears to be an attractive investment considering the strong fundamentals that support its growth. Mouwasat with diversified and widespread operations, relative to the other listed players, coupled with its aggressive expansion plans is most suitably placed to benefit from growing healthcare services demand in the Kingdom. As the company's hospitals operate at higher utilization levels, economies of scale are expected to accelerate earnings resulting in higher returns to the investors (ca.15% over 2012-18). At 2014E P/E of 18.2x, Mouwasat may not appear cheap; however, we believe that the stock warrants a premium keeping in view its strong track record and high profitability relative to the other listed players. Coverage of Mouwasat is initiated with a BUY rating and a target price of SAR 102/share, implying an upside of 18.6%.

Investment Case

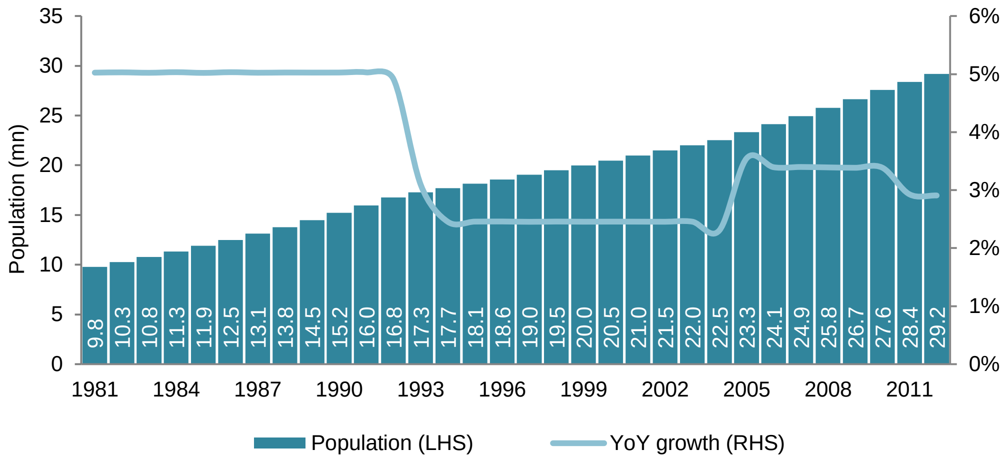
Favorable demographics

Strong population growth a demand driver for healthcare services

Critical mass of population (2012: 29.2mn) expected to grow at a CAGR of 1.7% vs. 1.1% for the World

The Kingdom of Saudi Arabia's (KSA's) population base is one of the major factors fuelling the demand for healthcare services. The country has the largest population base in the GCC and it accounted for ca. 66% of the region's population base (44.4 million). According to data available from the Saudi Arabian Monetary Agency (SAMA), the Kingdom's population stood at 29.2mn in 2012. Over the period 2000 to 2012, KSA's population increased at a CAGR of 3.0% which was well above the corresponding 1.2% for the World. Based on the UN Population database forecast, the country's population is estimated to reach 32mn in 2020 at a CAGR of 1.7% over the period 2010 to 2020. Saudi Arabia's population growth during this period is projected to exceed the World's corresponding population growth rate of 1.1%.

Fig. 3: KSA – Population growth, 1981 to 2012



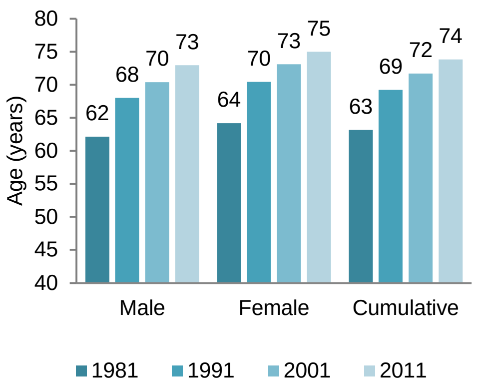
Sources: Saudi Arabian Monetary Agency (SAMA) and World Bank

Improvement in basic health facilities over the past 3 decades has yielded 'demographic dividends'

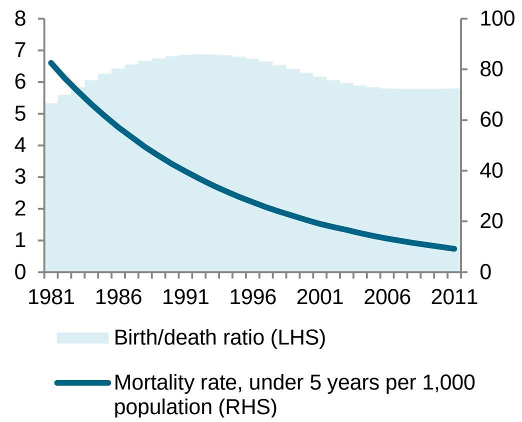
Growth in the Kingdom's population base over the last three decades is primarily attributable to significant improvements in basic health facilities. Average life expectancies have improved for both males and females. On average, life expectancy has improved by 11 years (74 years in 2011). Also, mortality indicators have improved - e.g. the Birth/Death ratio increased to 5.8 from 5.3 over the same period. The Government has expanded KSA's primary care delivery system by opening hospitals and Primary Healthcare Centers (PHCs). In addition, vaccination programs undertaken by the Government for the detection and control of diseases such as TB, malaria and bilharziasis have led to a significant reduction in the incidence of and resultant deaths from these diseases. The MOH has also initiated a survellience system program, based on WHO guidelines, to control non-communicable diseases.

Fig. 4: KSA – Improvement in Health Indicators, 1981 to 2011

(A) Life Expectancy



(B) Birth/Death ratio and Mortality Rate



Source: World Bank *Source: World Bank*

Demographic profile is supportive for sector growth

The age brackets of 23 to 31 and 60+ years are likely to help drive the demand for healthcare services in the KSA

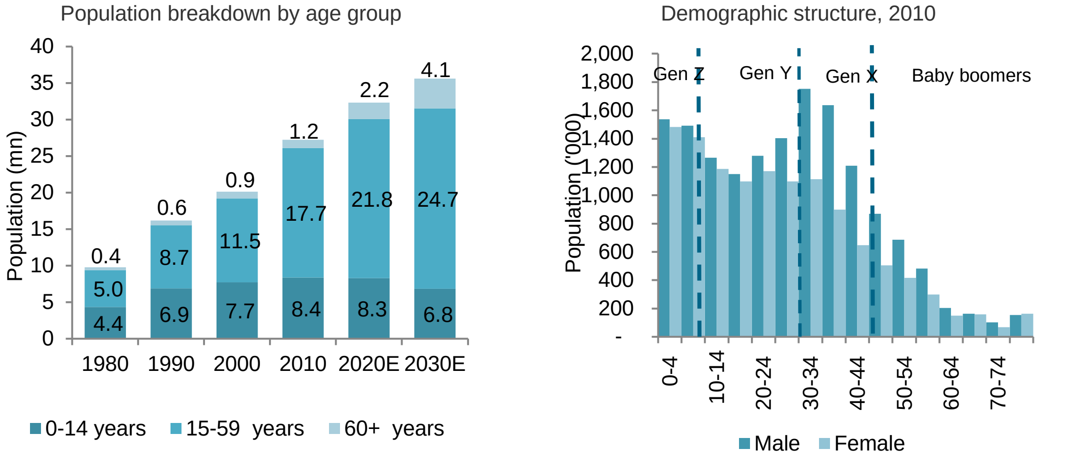
The KSA is a relatively young country with more than half its population below 29 years of age. The current average age group in the KSA is 23 to 31 years. Increasing at a CAGR of 2.1%, the population of this age group is forecast to reach a quantum of 22mn by 2020. The healthcare needs of this segment of the population are mainly related to primary health. Examples include obesity and illnesses related to the use of cigarettes and other substances. Psychiatric ailments and reproductive health issues are some of the other medical issues that this particular segment may typically require treatment. The healthcare cost per capita is usually lower for this population segment. Furthermore, the frequency of visits is less and the tenor of treatments is on the shorter side.

On the other hand, people in the 60+ years age group have proportionally higher healthcare costs per capita associated with the treatment of diseases such as heart ailments, hypertension and diabetes. Currently accounting for only 4.3% of the population, this is the fastest growing population segment in the Kingdom. Improved average life expectancy in the KSA brought about by a combination of health reforms, better treatment and availability of medication has reduced the death rate specific to this population group. Furthermore, a demographic shift is expected over next 20 years as the younger population ages and this could further increase the number of people falling in the 60+ category. The 60+ segment is projected to constitute 6.9% of the total population in 2020 and 11.5% in 2030.

According to health experts, 80% of an individual's healthcare needs typically arise in the post-retirement age. Considering that the frequency of visits is higher and that the tenor of treatment is protracted for the elderly population, the per capita health cost associated with this age group is usually higher. As a result, the KSA's rising elderly population is also expected to influence healthcare spending patterns going forward.

Saudi Arabia – Healthcare

Fig. 5: KSA - Demographic Profile



Source: UN Population database

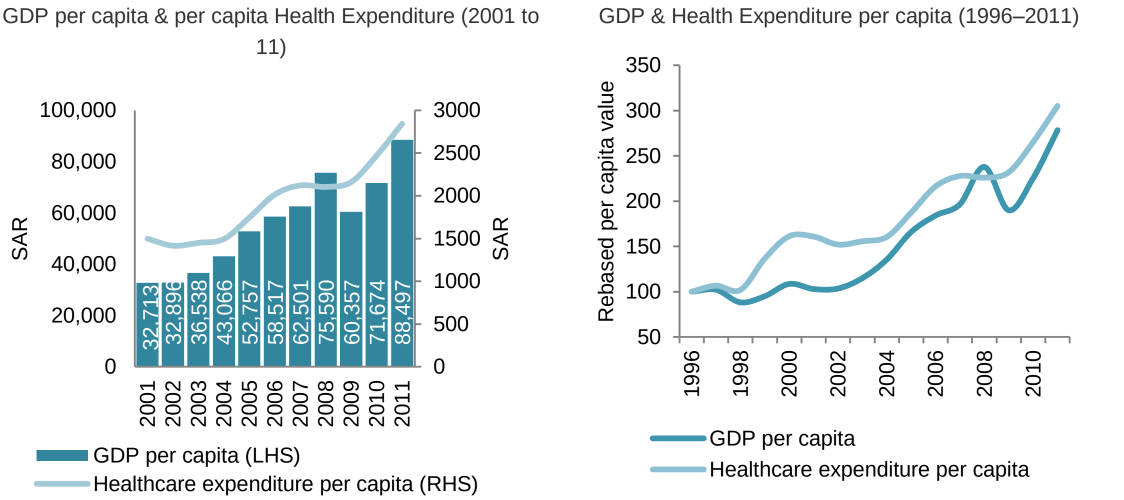
Source: Colliers International 2013

Rising income levels allow for higher healthcare spending

Rising income levels have enabled individuals to increase their healthcare spending

The demand for healthcare services is also influenced by disposable income. A higher disposable income allows for increased healthcare spending / capita. Over the period 2001 to 2011, GDP per capita in the KSA increased at a CAGR of 10.5% and was supported by a positive macroeconomic backdrop (strong oil prices, government reforms and an increased focus on developing the non-oil sector). This increased the per person spending on healthcare services. As a result, per capita health expenditure rose at a CAGR of 6.6% during the period 2001 to 11.

Fig. 6: KSA - Income and Healthcare Spending / Capita



Sources: SAMA and World Bank

Sources: SAMA and World Bank

Note: Per capita GDP and Health Expenditure rebased to 100 for 1996

Emergence of lifestyle diseases as a focus treatment segment

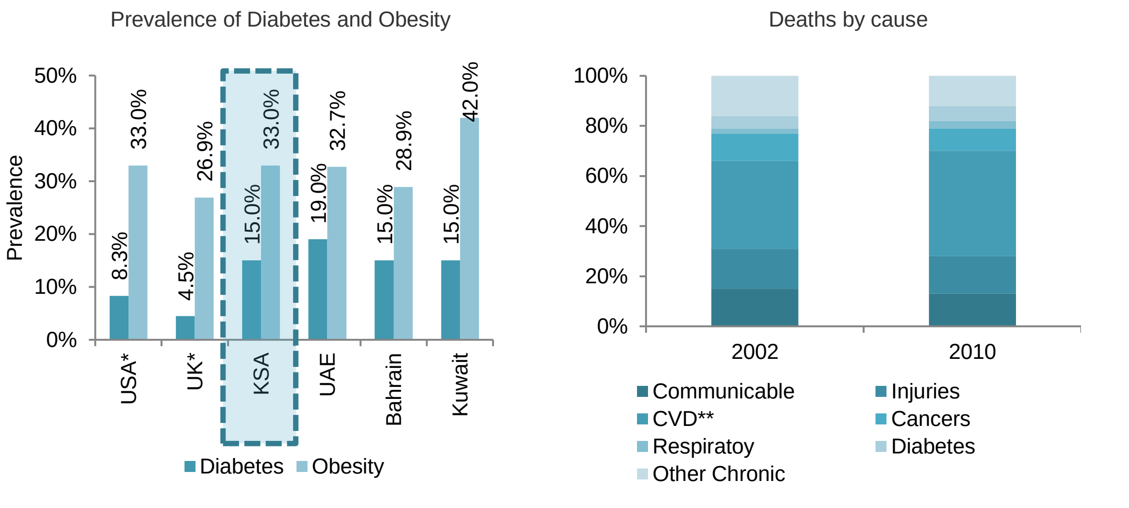
Higher income levels may have given rise to a more sedentary lifestyle, in turn leading to an increase in lifestyle related medical issues such as obesity and diabetes. The lifestyle linked medical issues were previously

Incidences of 'lifestyle diseases' have been on the rise

considered relatively uncommon in the KSA. Increased consumption of processed foods coupled with inadequate physical activity has led to the emergence of such diseases. Diabetes prevalence in the KSA is estimated at 15%, which is significantly higher than that in China: 4.2% and India: 7.8%. Perhaps more surprising is the fact that the percentage of the population in the country that is considered to be 'obese' is higher as compared to countries, such as the US and UK, that are known to have some of the highest obesity rates amongst developed nations. Higher rates of smoking among males (35 to 45% for adults and 24% for teenagers, Source: Ministry of Health, MOH) may have been one of the factors behind cancer cases. According to the MOH, the Kingdom is also ranked 23rd based on global tobacco consumption levels.

Moreover, treatment for lifestyle-related ailments is generally assumed to be costlier and typically extends over a longer period, which translates into higher healthcare related spending. As such, a continued increase in the incidence of lifestyle diseases is likely to stimulate the demand for specialized medical facilities and subsequently, stimulate healthcare spending.

Fig. 7: KSA – Lifestyle Diseases



Source: Ministry of Health Presentation, 2011 *Source: WHO*

*Note: *Diabetes information obtained from national sources* *Note: **CVD: Cardio Vascular Diseases*

Growing awareness of wellness

Improved literacy and growing urbanization levels have contributed towards creating greater awareness

Improved literacy levels (adult literacy rate 2010: 86.6%) coupled with rising urbanization (2011: 82.3%) have contributed in helping make people more aware of the importance of maintaining a healthier lifestyle as well as the merits of personal hygiene. Improved diagnostics and a growing awareness of well being are likely to exert a positive impact on the demand for healthcare services.

A robust population base coupled with a favorable macroeconomic backdrop (Real GDP Growth - 2012: 4.4%, 2013E: 4.2%, 2014E: 4.4%, Source: IMF) bode well for healthcare demand. According to Business Monitor International (BMI), the Kingdom is the largest healthcare services market in the GCC with an estimated market size of USD5.4 bn[1].

[1] BMI forecast 2Q 2013

[2] * Saudi Arabia's definition for nurses and physicians differs from that of the World Bank. The Ministry of Health (MOH) - Saudi Arabia, considers only registered nurses as nurses; whereas, according to the World Bank the nurses and midwives category includes professional nurses, professional midwives, auxiliary nurses, auxiliary midwives, enrolled nurses, enrolled midwives and other associated personnel, such as dental nurses and primary care nurses. SFC Research deploys the World Bank data point for Saudi Arabia, which allows for a more 'consistent' comparison.

Fig. 8: KSA - At a glance

Metric	Year	KSA	Arab countries	Developing countries	OECD	World
Total Population (mn)						
	1990	**15.2**	226.4	4,352.9	911.0	5,290.4
	2001	**28.4**	360.7	5,778.1	1,129.5	6,974.0
	2030	**38.5**	496.9	7,027.3	1,218.5	8,321.4
Annual growth rate of Population (%)						
	1990-1995	**2.7**	2.4	1.8	0.7	1.5
	2010-2015	**2.1**	2.0	1.3	0.5	1.1
Urban Population (% of total population)						
	1990	**76.6**	49.2	36.3	72.0	42.6
	2011	**82.3**	56.7	50.3	78.3	50.8
Literacy Rate, Adult (%)						
	2000	**79.3**	65.9	77.8	88.6	81.8
	2010	**86.6**	73.6	80.8	91.2	84.1
Life Expectancy (age in years)						
	1990	**68.8**	60.5	63.1	74.6	65.4
	2000	**71.5**	67.7	65.0	77.0	67.2
	2011	**74.1**	70.6	67.9	79.6	69.9
Crude Birth Rate (%)						
	1990	**5.26**	8.26	9.38	8.96	24.3
	2000	**4.31**	6.48	8.71	8.80	20.6
	2011	**3.74**	5.59	8.07	8.65	20.1
Crude Death Rate (%)						
	1990	**35.8**	34.7	28.5	13.5	25.9
	2000	**27.1**	28.5	23.3	11.9	21.4
	2011	**21.5**	25.4	20.9	11.0	19.3
GDP per capita (in USD, based on purchasing power parity)						
	2005	**13,517**	6,716	5,282	29,197	9,543
	2010	**16,541**	4,774	4,952	40,976	9,120
	2011	**21,046**	8,554	6,147	33,352	10,082

Sources: SAMA and World Bank

Note: Arab countries include 22 nations and territories of the Arab league; Developing countries as defined by the World Bank; OECD – Organization for Economic Cooperation and Development

Supply gap exists

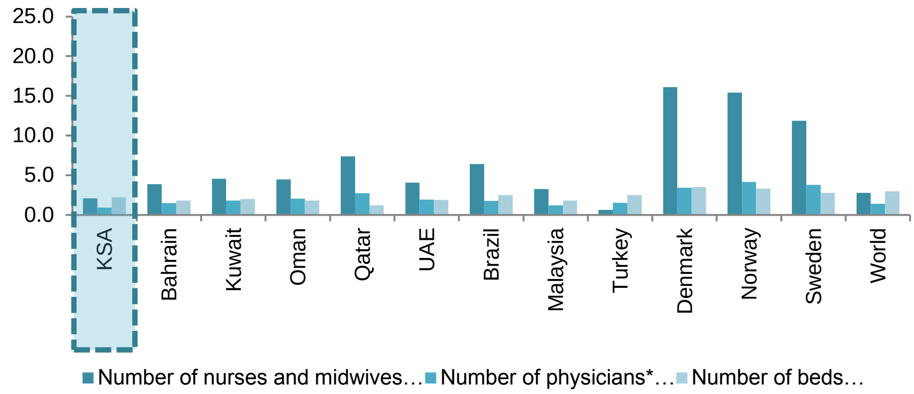
An underserved market

KSA's current healthcare services supply deficient to meet strong demand

Inspite of significant demand, the KSA healthcare sector is far from mature when compared with other emerging markets. The Kingdom lags behind in its healthcare infrastructure vis-à-vis many developed healthcare markets, emerging countries and World averages. The number of nurses per 1,000 people in the KSA stands at 2.1 vs. the World average of 2.8. Additionally, the number of physicians per 1,000 people in the KSA is 0.9, which is also lower than the world average of 1.4. The aforementioned data points suggest that the supply of qualified

healthcare personnel, which form a crucial component of the healthcare delivery framework, is below global standards. The observation is further supported by the fact that bed density (i.e. the number of hospital beds per 1,000 people) is 2.2 compared to the World average of 3.0. Considering the demand potential in the country, the supply of resources available to provide quality healthcare services remains somewhat deficient.

Fig. 9: KSA - Comparison of Healthcare Infrastructure, 2010

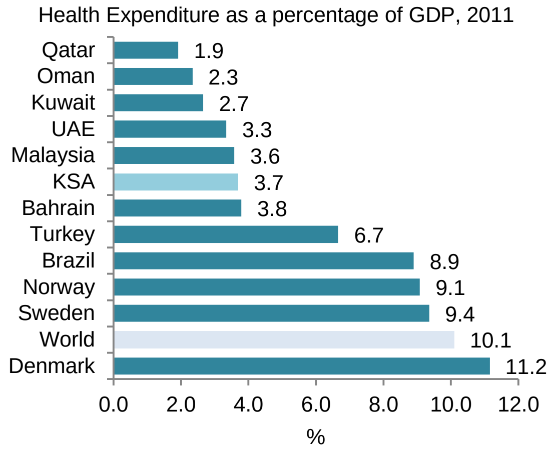


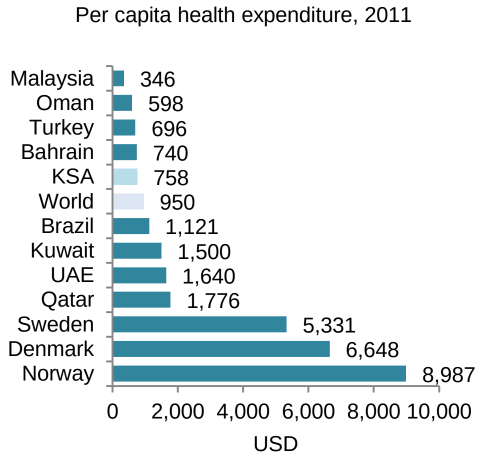
Source: World Development Indicators Report 2012
Note: [2]; Refer to footnote for details on data compilation methodology

KSA's healthcare expenditure contribution is low when compared to other developed countries

The KSA Government's healthcare expenditure to GDP (3.7%), while on the higher side within the GCC peers, lags behind that in the Scandinavian block, emerging countries as well as the World average (10.1%). Per capita health expenditure is one of the lowest when compared to developed markets and other GCC member countries. In spite of relatively high income levels, the per capita health expenditure / GDP per capita is approximately 4% relative to 9% for the World.

Fig. 10: KSA - Healthcare Expenditure vs. GCC, Scandinavian and Emerging Countries, 2011





Source: World Bank

Source: World Bank

[2] * Saudi Arabia's definition for nurses and physicians differs from that of the World Bank. The Ministry of Health (MOH) - Saudi Arabia, considers only registered nurses as nurses; whereas, according to the World Bank the nurses and midwives category includes professional nurses, professional midwives, auxiliary nurses, auxiliary midwives, enrolled nurses, enrolled midwives and other associated personnel, such as dental nurses and primary care nurses. SFC Research deploys the World Bank data point for Saudi Arabia, which allows for a more 'consistent' comparison.

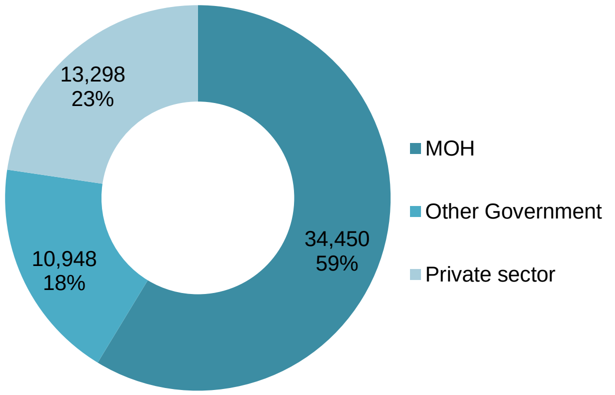
The public sector accounted for 77% of the total bed capacity in 2011

Government (via MoH) as a key sector economic agent

The strong demand potential in the KSA in the absence of a widespread and mature healthcare infrastructure is a positive as it provides opportunities for growth. There has been a significant increase in the number of Outpatients and Inpatients in the KSA with the average number of visits per person per year rising to 5.2 in 2009 from 4.7 in 2002. Moreover, the total number of Outpatients grew to 131.2mn in 2009 from 102.4mn in 2002 and the number of inpatients increased to 3.0mn in 2009 from 2.3mn in 2002.

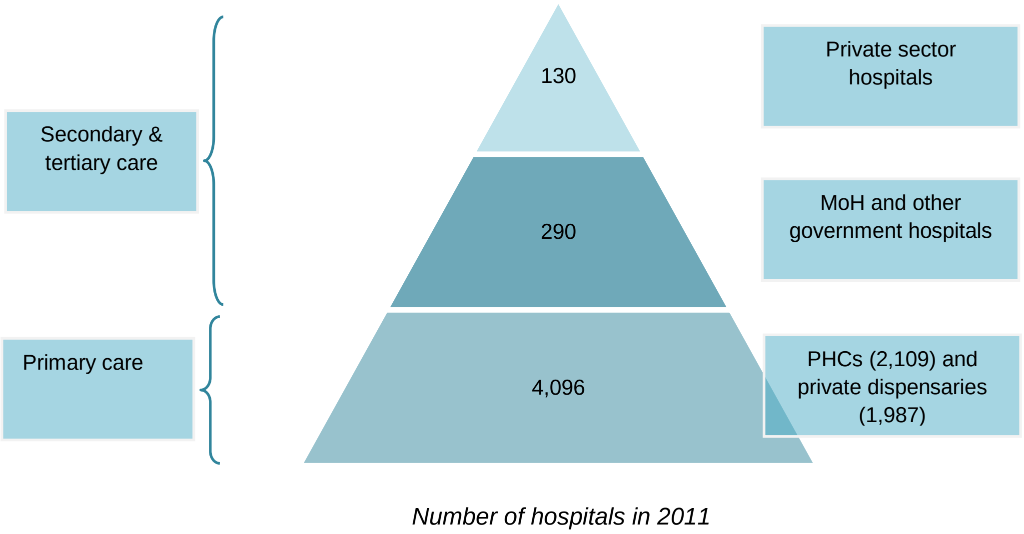
To meet rising patient numbers, currently there are 2,109 Primary Health Centers (PHCs), 1,987 private dispensaries and 420 hospitals providing healthcare facilities in the Kingdom. The PHCs act as the initial point of contact for most patients; whereas hospitals and private dispensaries play the role of secondary providers as they generally accept referrals from the PHCs. As such, the specialized hospitals act as tertiary care providers.

Fig. 11 (A): KSA - Hospital Bed Capacity: Public vs. Private, 2011 (# of beds, % share)



Source: Ministry of Health

Fig. 11 (B): KSA - Healthcare Infrastructure

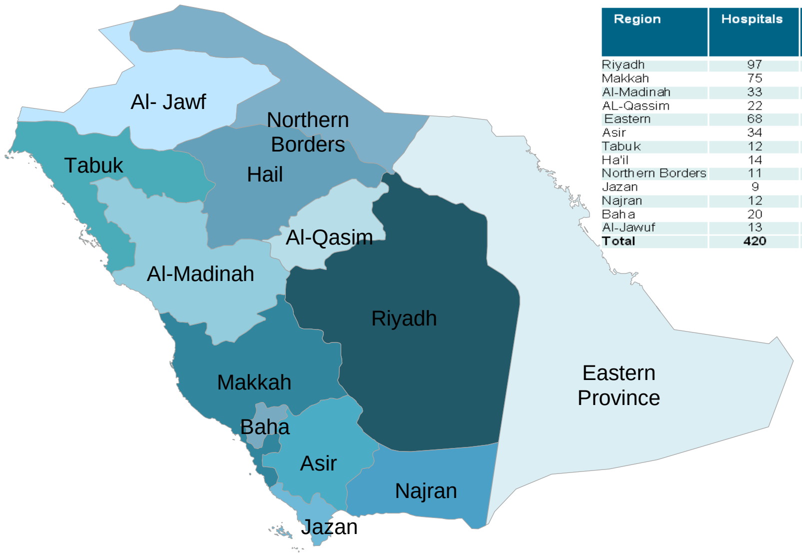


Source: Ministry of Health

In 2011, the Government operated 69% of the hospitals via the MOH and semi-government organizations. These hospitals accounted for 77% of the total bed capacity. Private hospitals provide for the remaining 31% and 23% of the total number hospitals and bed capacity, respectively.

Fig. 12 (A): KSA - Regional Distribution of Medical Facilities

Major cities are hubs for medical facilities in the KSA



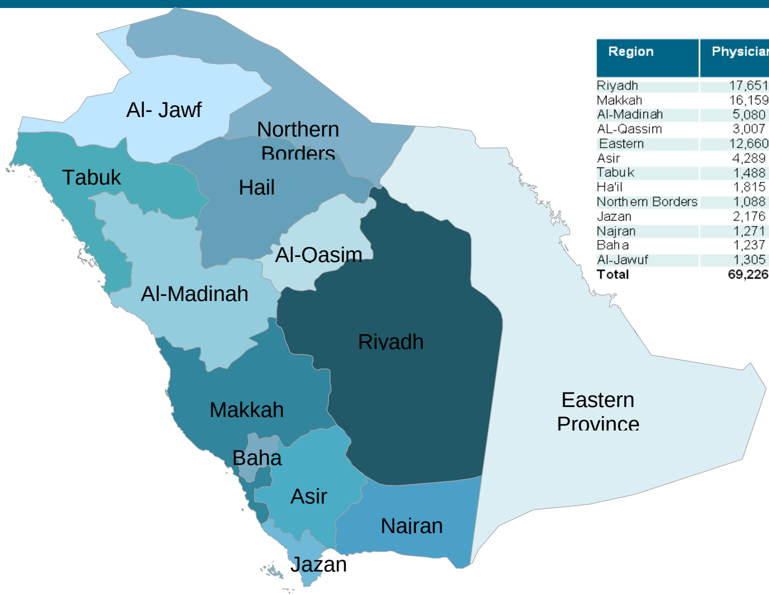
Region	Hospitals	Beds	PHCs & private dispensaries
Riyadh	97	15,682	1,087
Makkah	75	11,367	835
Al-Madinah	33	4,219	167
AL-Qassim	22	2,950	228
Eastern	68	9,878	442
Asir	34	4,080	418
Tabuk	12	1,491	108
Ha'il	14	1,435	127
Northern Borders	11	1,190	67
Jazan	9	2,074	188
Najran	12	1,500	101
Baha	20	1,425	160
Al-Jawuf	13	1,405	80
Total	**420**	**58,696**	**4,008**

Source: *Ministry of Health*

About 65% of KSA's population is concentrated in Riyadh, Makkah and the Eastern Province

Most hospitals (ca. 57%) and a large proportion of the bed capacity (ca. 63%) in the KSA are / is concentrated in the urban pockets – Riyadh, Makkah and the Eastern region. Even in terms of the medical personnel employed, Riyadh, Makkah, and the Eastern region accounted for the majority (ca. 67% of physicians and 63% of nursing staff). Riyadh, Makkah, and the Eastern Province are also the primary demand centers for the KSA healthcare services sector and constitute about 65% of the Kingdom's population.

Fig. 12 (B): Regional distribution of Medical Personnel



Region	Physicians	Nursing staff	Allied Health Personnel
Riyadh	17,651	32,910	21,081
Makkah	16,159	28,513	16,182
Al-Madinah	5,080	11,096	5,957
AL-Qassim	3,007	6,656	4,359
Eastern	12,660	23,603	13,528
Asir	4,289	8,667	6,092
Tabuk	1,488	3,327	1,459
Ha'il	1,815	3,653	1,726
Northern Borders	1,088	2,423	1,064
Jazan	2,176	4,633	2,939
Najran	1,271	2,921	1,567
Baha	1,237	2,834	1,365
Al-Jawuf	1,305	3,396	1,504
Total	**69,226**	**134,632**	**78,823**

Source: *Ministry of Health*

Public healthcare spending to aid growth

In an attempt to try to address the supply deficit, the government has made investments to upgrade and expand the Kingdom's healthcare infrastructure. These investments have focused on building more PHCs, hospitals,

In 2013, health and social development expenditure as a proportion of total expenditure was 12.2%, which is higher than the previous years

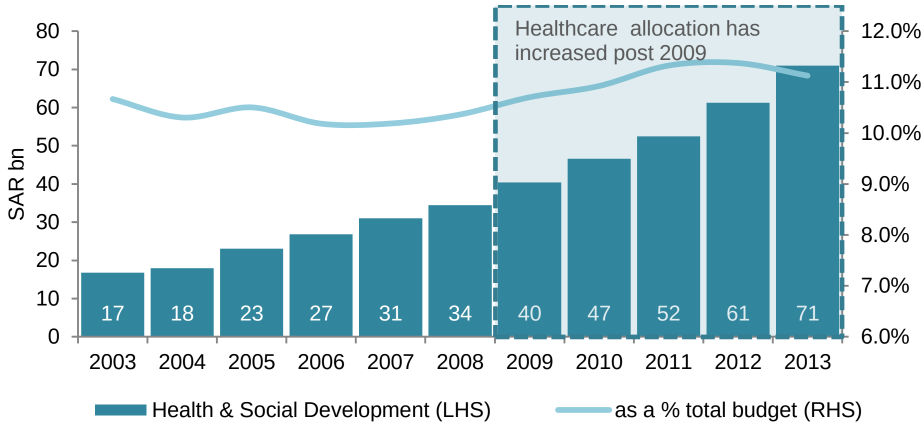
Allocations to health and social development expenditure increased at a CAGR of 15.5% over 2003 to 13

Five new medical cities are expected to come online in the KSA

and medical cities. The government also increased its allocation to healthcare expenditure over the past decade. The KSA government in its ninth Five-Year Plan (2010 to 14) allocated SAR 274bn (USD 73.1bn) for the development of the healthcare sector. The plan included the construction of 120 hospitals, 200 PHCs and 400 emergency centers. With the implementation of this plan, the government intends to improve bed density to 3.5 from 2.2 currently.

As evident from the Saudi Government's spend on education and healthcare over 2004 to 08, healthcare and social development (this sub category includes expenditure on social and rehabilitation centers, social security offices and sports centers) accounted for an average of 10% of the total budgeted expenditure. In the 2013 budget, healthcare and social development spending was ca. set at 12.2% of the total expenditure.

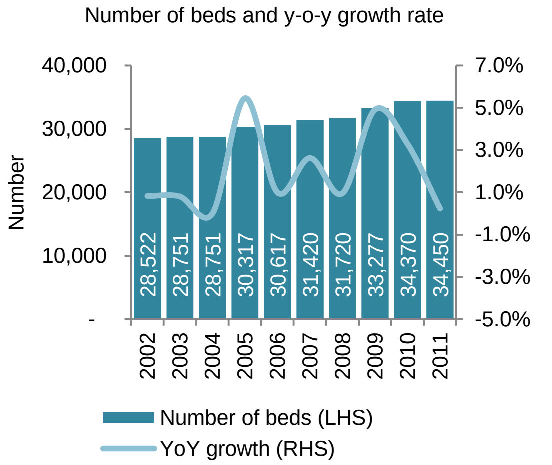
Fig. 13: KSA - Healthcare and Social Development Budget Allocation, 2003 to 2013

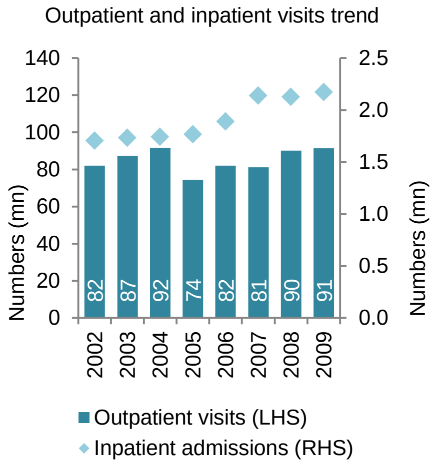


Source: SAMA

While cumulative healthcare allocations during 2006 to 08 stood at SAR 92bn, the aggregate increased significantly over 2009 to 13, during which the government allocated SAR ca. 272bn. The increased allocation was driven by the government's renewed focus on uplifting the healthcare system post the political and social uprisings in the greater Middle East and North Africa (MENA) region. As a result, spending on healthcare and social development as a proportion of the total budget has been rising. In the 2013 budget, the government allocated SAR 15.1bn (21.3% of the allocation for healthcare and social development) for 22 new health projects, which include 19 new hospitals and 3 healthcare centers. In addition, the government will continue spending on existing projects for the construction of 102 hospitals and PHCs. Furthermore, the Government intends to improve access to specialist care in different regions. In order to achieve this goal, five integrated medical cities with a total capacity of 6,200 beds are being established to provide high-quality healthcare services to the population.

Fig. 14: KSA – Public Sector Hospitals: Key Metrics (2002 to 2011)





Source: Ministry of Health

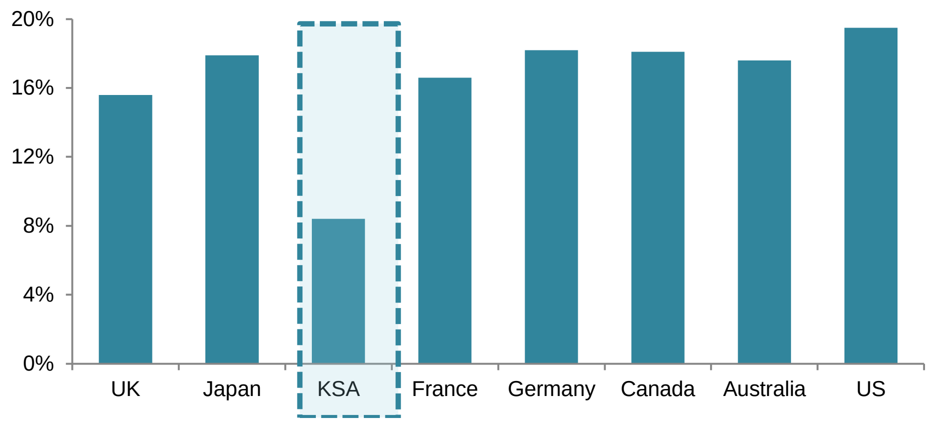
Source: Ministry of Health

Facilitated by an increase in government expenditure, government sponsored hospitals accounted for the majority of the increase in the number of hospitals and beds over the past few years as compared to the private operators. While the number of beds increased to 34,450 in 2011 from 28,522 in 2002, the number of MoH hospitals increased to 251 from 195 during the same period. Inpatient and Outpatient visits also increased mirroring growth in the MOH hospitals infrastructure.

Increasing private sector participation critical for meeting supply deficit

Although the government's health expenditure increased to SAR 34.5bn in 2011 from SAR 27.6bn in 2003, as a percentage of GDP, it reduced to 3.7% in 2011 from 4.0% in 2003 and is currently below the World average of 10.1%.

Fig. 15: KSA - Healthcare Expenditure vs. Developed Countries (% of Total Budget)



Source: Ministry of Health Presentation 2011

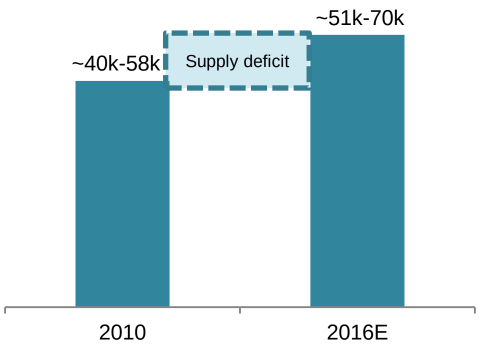
The Government needs to invest ca. USD20bn to meet healthcare requirements of a growing population base

The current healthcare services supply infrastructure is inadequate to meet the Kingdom's healthcare demands. In order to meet the KSA's growing health needs in line with global standards, the government will need to further increase its budgetary allocation to the sector. Based on the Saudi Arabian General Investment Authority (SAGIA) estimates, with a rising population base, the demand for hospital beds is expected to grow to 51,000 to 70,000 from the current 40,000 to 58,000 with the number of hospitals likely to rise to 502 by 2016 from 364. To

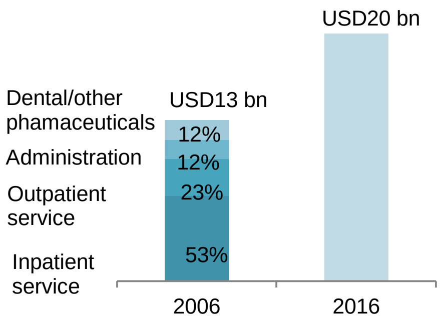
finance the aforementioned expansion, the government will be required to incur additional spending of USD20bn by 2016.

Fig. 16: KSA – Healthcare 'Supply Deficit'

Current and future bed capacity to meet demand prospects



Projected Saudi expenditure



Sources: SAGIA and Booz and Company Healthcare Investment Report

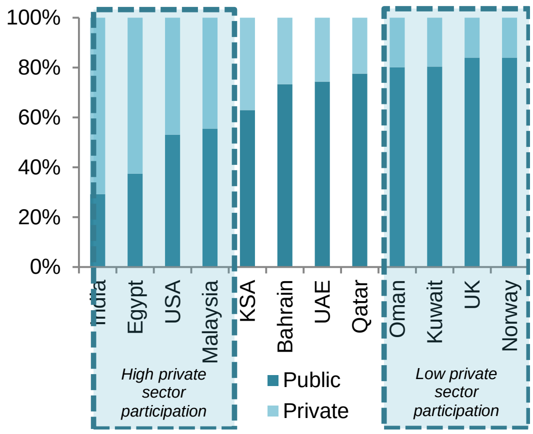
Sources: SAGIA and Booz and Company Healthcare Investment Report

Additionally, increased private sector involvement for enhancing the effectiveness of the country's healthcare system is required. Currently, private sector participation is low in the KSA healthcare sector. In 2011, the government (including MOH and quasi government facilities) accounted for 78% of the bed supply and the private sector accounted for the remainder (i.e. 23%). The private sector accounted for 32% of total health expenditure in the country, which is lower than that in developed countries, such as the US and also emerging countries, such as India and Malaysia. Considering the state of the healthcare infrastructure, greater private sector involvement is necessary not only to reduce the government's spending burden but also to bring about greater efficiencies to the day to day functioning of the KSA healthcare sector.

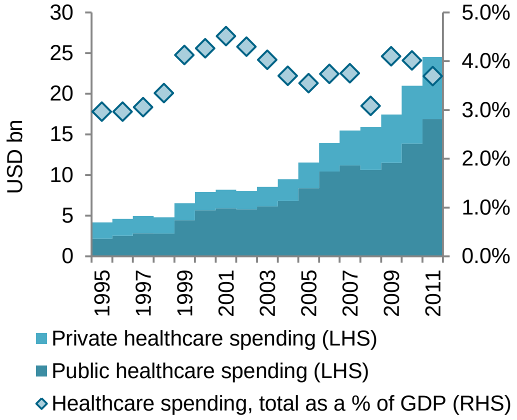
KSA's private sector participation rate highest among GCC countries

Fig. 17: KSA - Private Sector's Participation

Public and private sector healthcare break-up (%) , 2010



Public and private sector spending in KSA, 1995-2011



Source: World Bank

Source: World Bank

Other Topics

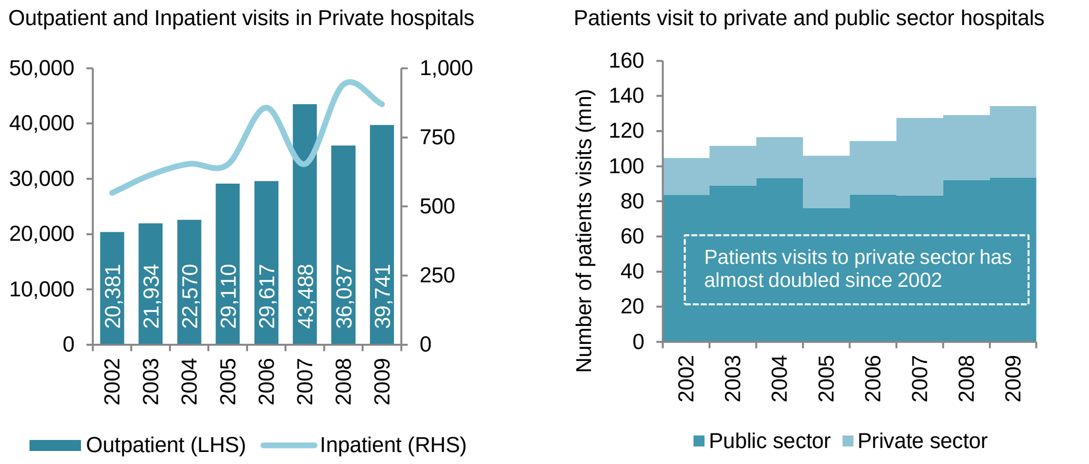
Conducive environment for Private sector participation

Demand for the provision of healthcare services by the private sector is influenced by the changing perception of patients and a rising expatriate population

The private healthcare sector in the KSA has witnessed significant increase in patient inflow over the past few years. Rising urbanization and higher income levels have contributed to an increase in the demand for private care. Moreover, the demand for private healthcare has also benefited from people's evolving perception of the provision of healthcare services by the private sector.

In addition to a change in preference for private healthcare, the growing demand from the expatriate population (32% of total population) has also led to a rise in Inpatient and Outpatient traffic at private sector hospitals. MoH facilities are more focused on the treatment of Saudi nationals; whereas expatriates are treated at the MoH hospitals primarily for specialized care or in rural areas where private clinics may not be in close proximity.

Fig. 18: KSA - Private Sector participation in Healthcare



Source: Ministry of Health   *Source: Ministry of Health*

Increased Private sector participation will reduce the financial burden of the government and bring in more efficiency to the sector

Historically, the MOH has played a vital multi functional role not only as a provider of healthcare services but also in the capacity of a financier as well as the regulator of healthcare facilities. With a growing population, rising incidences of health issues amongst the population and escalating medical costs, the government may not be able sustain all 3 roles. Moreover, as the government moves closer towards its aim of bridging the gap between the domestic healthcare system and international standards, it will not only require additional investments but also the support of the private sector. A more prominent role for the private sector will help bridge the funding gap as well as contribute to the existing expertise in providing healthcare services. Keeping in view the context, the MoH is considering liberalizing the healthcare sector to boost investments from the private sector. Private sector players are being encouraged to invest by borrowing on 'soft' terms over longer tenors. Moreover, the government increased the funding cap allowed by the MoH to private hospitals to SAR 200mn from SAR 50mn in 2011. Such initiatives aim at attracting investments from the private sector.

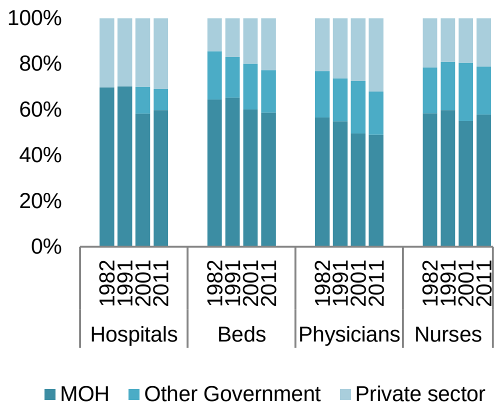
Some of the private players have embarked on larger capital expenditure plans to meet growing demand. Companies have tapped capital markets to fund these expansion plans - Mouwasat Medical Services Company (4002 / MOUWASAT AB) listed on the Tadawul in August, 2009, followed by Dallah Healthcare Company (4004 / DALLAH AB) in December, 2012 and National Medical Care (4005 / CARE AB) in March 2013.

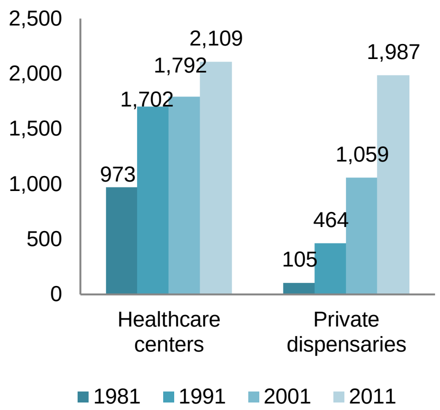
Fig. 19: KSA - Major Healthcare projects undertaken by the Private Sector

Project name	Region	Project value (USD million)	Facility type	Completion date
Mouwasat	Riyadh	88	Hospital	1Q 2014
Mouwasat	Jubail	24	Expansion of existing facility	1Q 2015
Mouwasat	Al-Khobar	96	Hospital	1Q 2018
Dallah	Riyadh	23	Expansion of existing facility	2013-end
Dallah	Riyadh	133	Hospital	2017
Riyadh Medicine Company	Riyadh	-	Hospital	April 2014
Al Shoula	Riyadh	500	Mixed-use	4Q 2015

Sources: Zawya Projects, Company Data

Fig. 20: KSA - Healthcare Infrastructure at a glance





Source: Ministry of Health;
*Note: *Other Government hospital data unavailable for 1982*

Source: Ministry of Health

Focus on building the sector workforce

The Saudi government is investing in medical education and training to develop as well as strengthen the available pool of qualified medical professionals

As per a two-pronged approach, the government is focused on the expansion of the existing healthcare infrastructure as well as capacity building for the healthcare workforce. The sector's workforce is a key component of day to day operations, particularly the delivery mechanism to both Inpatients and Outpatients. Cognizant of this link, the government has also increased spending on developing the requisite education infrastructure so as to facilitate medical education. Investment in medical education is likely to enhance the appeal of healthcare sector jobs to Saudi nationals. The training of healthcare personnel with a view towards skills up gradation has also been part of the agenda. In context of the aforementioned, noteworthy steps undertaken by various government authorities are:

- An allocation of SAR 4.25bn in the 2013 budget for building three new medical colleges. Moreover, Jazan University is currently undergoing an expansion (SAR 3bn), which will also include the construction of four medical colleges.
- In 2012, the MoH announced several initiatives for enhancing the skills of medical professionals through training, knowledge sharing and technology. The Ministry increased its spending on training to SAR 350mn over the last three budgets as compared to SAR 150mn previously. As a part of these initiatives, the MoH

will develop a Healthcare Learning and Simulation center in Riyadh to offer training to professionals. It also plans to deploy a new e-health interoperability standards program to improve access, patient safety and quality of healthcare services offered.

- Collaboration of government universities with various foreign universities for strategic research.
- Scholarship provisions for students which can be availed through the King Abdullah Scholarship Program
- Information technology is also gaining prominence in the KSA healthcare sector as a medium that supports the delivery of quality health care services that are in line with global health standards. The Healthcare Information and Management Systems Society (HIMSS) was also launched for the digital integration of 220 hospitals and 2,000 PHCs. This project was re-introduced in May 2011 to include deployment of e-file and e-medical records for the past nine years.

Fig. 21: KSA - Key Healthcare Projects

Project name	Region	Project value (USD million)	Phase	Facility type	Expected Completion date
King Abdullah Medical City	Makkah	5,333	Design-Execution	Medical City	2015
King Fahd Medical City Expansion	Riyadh	1,121	Construction-Execution	Medical City	Sep. 2015
King Faisal Medical City	Asir	1,000	Construction-Execution	Medical City	2021
King Khalid Medical City	Al Sharqiyah	1,200	Construction-Prequalification	Medical City	Aug. 2017
King Faisal Specialist Hospital and Research Center Expansion (KFSHRC)	Makkah	900	Construction-Awarded	Hospital and research center	2016
Prince Mohammad Bin Abdulaziz Medical City	Al Jawf	533	Construction-Execution	Medical City	2018
National Center for Neuroscience, Comprehensive Cancer Center, Heart Center Laboratories Buildings	Riyadh	317	Construction-Execution	Building, bridge	Q4 2014
King Abdullah Center For Tumor and Liver Diseases	Riyadh	242	Construction-Execution	Hospital	Q4 2013
Jazan Specialized Hospital	Jazan	192	Construction-Execution	Hospital	Q2 2015
Aseer Specialized Hospital	Aseer	171	Construction-Execution	Hospital	Q2 2015

Source: Zawya Projects

Forward looking regulatory practices will aid growth

KSA government formulating policies to attract investment for the sector's development

The KSA government has undertaken various policy initiatives to facilitate the transition towards a more efficient and dynamic healthcare system while remaining committed to increasing the number of patients with access to medical facilities. In the year 2000, the MoH established the Health Services Council (HSC) to ensure the development of an effective policymaking structure and to support implementation of government programs.

The Health Services Council (HSC)

- Coordination and integration of activities between the public and private sectors
- Ensuring optimum utilization of health facilities and available resources
- Identification of financing alternatives for healthcare services as well as for hospital operations
- Devise guidelines to be followed for the establishment of any new healthcare facilities
- Ensure balanced distribution of healthcare services across regions
- Selection of adequate alternatives in the field of healthcare insurance
- Undertake national-level research activities and conduct studies in the health services field
- Synchronize educational and training institutions' activities to increase the number of Saudi nationals in healthcare sector operations

The introduction of a healthcare program for expatriates is one such initiative. As the expatriate population accounts for ca. 32% of the total population, its inclusion in the insurance ambit is expected to have a pronounced impact on demand. In January 2006, the Kingdom implemented mandatory medical insurance coverage for all expatriates working in companies that have more than 500 non-Saudi employees. This was later extended in two phases: initially, to firms with over 100 expatriate employees and subsequently, to firms with more than 50 non-national employees. The government is extending mandatory insurance coverage even for Saudi nationals. Although a comprehensive medical insurance scheme for Saudi nationals has been contemplated in the past, it has been delayed by another five years. The inclusion of Saudi nationals under mandatory medical insurance coverage would also significantly boost the demand for healthcare services in the Kingdom.

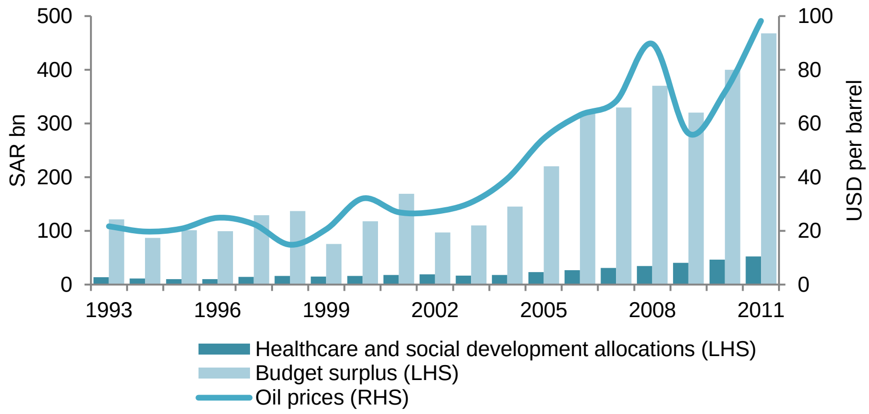
In addition to the aforementioned policy changes, the government is reviewing policies with a view towards the evolution of a regulatory framework that creates a conducive environment for attracting investments from the private sector. By encouraging mergers and acquisitions activity amongst healthcare providers and providing funding assistance through soft loans at lower rates, the government aims to facilitate private sector expansion. Additionally, the KSA government aims to provide incentives to highly qualified medical professionals to obtain their services in the Kingdom's healthcare sector.

Macro Risks

Decline in oil prices

The government's expenditure on healthcare sector development is significantly dependent on its revenues, which in turn, are influenced by oil prices. With the exception of the 2008 downturn, a stronger fiscal position has corresponded with a rise in oil prices. A stronger fiscal position (via higher revenues) has also allowed for higher government spending (in absolute terms) on the healthcare sector. A sharp and / or prolonged decline in crude oil prices will potentially impact government revenues directly and in turn, government expenditure on the healthcare sector.

Fig. 22: KSA - Fiscal position and Healthcare Spend, 1993 to 2011



Sources: SAMA, Bloomberg

Note: North Sea (Brent) prices (in Real terms) used a proxy for crude oil prices

Policy formulation

Saudi Arabia's healthcare sector offers strong demand dynamics; however, the supply side remains weak due to a constrained hospital and supporting healthcare infrastructure. In order to meet the growing health needs of an expanding population base, an additional capacity of ca. 11,000 beds would be needed by 2016E. The government may not be able to fund the entire capacity expansion by itself as its ability to do so is driven by the prevailing macroeconomic environment. As such, private sector participation is expected to increase particularly as the government conceptualizes and formulates policies and develops a regulatory framework that encourages investments in healthcare from the private sector. A restrictive policy that discourages private sector participation would adversely affect the already delicate supply dynamics that exist for the Kingdom's healthcare sector.

Labor market distortions

The Saudi healthcare sector faces a shortage of trained medical staff, which is an essential component for day to day functioning. In order to compensate for the shortage, the Kingdom relies on expatriates. 32% of the nurses and 23% of the physicians are non-Saudi nationals. Certain segments in the expatriate workforce may prefer to return to home countries and / or relocate to developed markets, which results in attrition. Attrition, particularly from the expatriate sector workforce, can impact the availability of qualified professionals within the country and potentially increase labor costs. Accelerated implementation of the Saudization program is also expected to exert upward pressure on the healthcare sector's cost structure and could translate into margin compression for some of the operators.

Company Profiles

Overview

Revenues of the three listed private healthcare players in the KSA have increased consistently over the last 4 quarters (4Q 2012 to 3Q 2013, 4Q 2012: +17% YoY, 1Q 2013: +15% YoY, 2Q 2013: +12% YoY, 3Q 2013: +14% YoY); however Net Profits over the last two quarters have shown weakness. The 2Q 2013 performance was influenced by higher costs (+18% YoY). On the other hand, 3Q 2013 Net Profit growth (-15% QoQ & +5% YoY on an aggregate basis for the 3 companies – Mouwasat, Dallah and Care) was slower as patients' visits are typically lower in summer vacations and during Ramadan. For the most recent quarter ended (i.e. 3Q 2013), Mouwasat accounted for the majority of the aggregated Revenue (41% vs. 42% in 4Q 2011) and Net Profits (52% vs. 39% in 4Q 2011) of the three listed private players in the Kingdom.

		4Q 2011	1Q 2012	2Q 2012	3Q 2012	4Q 2012	1Q 2013	2Q 2013	3Q 2013
All figures in SAR Million unless otherwise stated									
Mouwasat									
Revenues		190	196	201	187	213	219	229	212
	YoY change		17.2%	21.6%	19.3%	12.3%	12.1%	14.0%	13.0%
Costs		(148)	(142)	(149)	(150)	(169)	(161)	(169)	(163)
	YoY change		17.4%	20.8%	28.2%	14.5%	13.2%	13.5%	8.4%
Net Profit		35	46	47	35	43	53	54	44
	YoY change		18.4%	16.7%	5.1%	22.6%	13.3%	14.6%	24.5%
EPS (SAR / share)		0.69	0.93	0.95	0.71	0.85	1.05	1.08	0.88
	YoY change		18.4%	16.7%	5.1%	22.6%	13.3%	14.6%	24.5%
Dallah									
Revenues		142	154	161	142	178	184	188	167
	YoY change		18.5%	15.8%	22.5%	25.2%	19.3%	16.4%	17.4%
Costs		(118)	(116)	(123)	(120)	(144)	(145)	(158)	(145)
	YoY change		16.0%	9.1%	21.4%	22.3%	25.6%	28.0%	21.0%
Net Profit		36	38	37	24	37	39	24	22
	YoY change		7.7%	36.7%	54.3%	5.1%	2.8%	-36.3%	-8.6%
EPS (SAR / share)		0.75	0.80	0.79	0.51	0.79	0.83	0.50	0.46
	YoY change		7.7%	36.7%	54.3%	5.1%	2.8%	-36.3%	-8.6%
Care									
Total Revenues		118	129	137	121	138	145	142	135
	YoY change		13.0%	15.1%	13.6%	16.2%	12.8%	3.6%	11.2%
Costs		(98)	(100)	(107)	(99)	(114)	(114)	(121)	(117)
	YoY change		17.4%	16.8%	12.8%	16.4%	14.2%	12.8%	17.9%
Net Profit		19	29	30	21	25	31	22	19
	YoY change		1.1%	3.3%	15.8%	28.8%	7.8%	-25.0%	-12.4%
EPS (SAR / share)		0.43	0.64	0.66	0.48	0.56	0.69	0.49	0.42
	YoY change		1.1%	3.3%	15.8%	28.8%	7.8%	-25.0%	-12.4%

Sources: Company reported, Saudi Fransi Capital analysis

Mouwasat Medical Services

Mouwasat – Leading the pack

- **Wide presence strengthens position among listed players:** Mouwasat's major market share among the listed players in the Kingdom's healthcare sector positions it as an attractive scrip to investors seeking KSA healthcare exposure. The company commands 4.7% of the private players' market share in terms of Outpatient visits and 8.1% of Inpatient flow, the largest among the listed players in the KSA. As compared to the other listed players, Mouwasat benefits from its widespread network (four hospitals located in the Eastern and Western regions). Mouwasat's stronghold is the KSA's industrial hub, i.e. the Eastern region with an Outpatient share at 16% and an Inpatient share at ca. 28%. The company caters to demand from large corporate clients as well as from the general public. Additionally, its presence in Riyadh (expected in 1Q 2014) and Madinah, which together house ca. 32% of the Kingdom's population, further strengthens Mouwasat's position.

- **Expansion plans further strengthen strategic position:** Mouwasat's expansion plans are another positive considering the demand potential for healthcare services in the KSA. The company's bed capacity and clinics are expected to increase 83% and 52%, respectively, over the period 2012 to 18E as a result of two new hospitals coming online in Riyadh and Al-Khobar in 2014 and 2018 respectively. Moreover, the Jubail facility expansion is expected in 1Q 2015. The company expects to incur total capital expenditure of SAR 780mn over 2012 to 18 for building up capacity, which in turn will account for c.45% of growth in Revenue (CAGR c.15.1%). The expansion plan will potentially position Mouwasat well to tap the rising demand for healthcare services in the KSA.

- **Increase in prices to aid margin preservation:** The company's ability to negotiate pricing with insurance and cash customers is expected to aid in a 5 to 10% improvement in the price per patient over the forecast period. Although new expansions are likely to result in higher costs per patient and lower utilization levels in the initial days (i.e. start-up phase), we expect Mouwasat's ability to increase prices to limit the downward impact on the margins. Also, rising prices and the absence of any new capacity-related costs are likely to result in higher margins in 2013; however, going forward, operating margins are expected to be maintained around 24% due to lower utilizations, additional staff costs and promotional expenses.

- **Initiate with BUY recommendation and target Price of SAR 102/share:** Mouwasat's strong operating cash flow momentum (Cash and cash equivalents stood at SAR 132mn at end 3Q 2013), coupled with financial assistance from the government, place it suitably to fund capex plans. Mouwasat is expected to maintain a 50% Dividend Payout implying a Dividend Yield range of 2.2 to 4.6% over 2012 to 18E. Upside risks include higher utilization levels and additional capacity expansion plans. Downside risks to our target price (computed using a blended valuation approach comprising of Discounted Cash Flow analysis and a Relative Valuation approach derived from P/E and EV/EBITDA multiples) include weaker pricing dynamics and delays in new hospital launches.

Rating Summary

Recommendation	**BUY**
Target price (SAR)	**102**
Upside/(Downside)	**18.6%**

Stock Details

Current Price*	SAR	86.0
Market Capitalization	SAR Mn	4,300
Shares Outstanding	Mn	50
52-Week High	SAR	92.5
52-Week Low	SAR	48.2
Price Change (YTD)	%	60.0
EPS 2014E	SAR	4.7
Ticker (Reuters/ Bloomberg)	4002.SE	MOUWASAT AB

* *Price as of November 25, 2013*

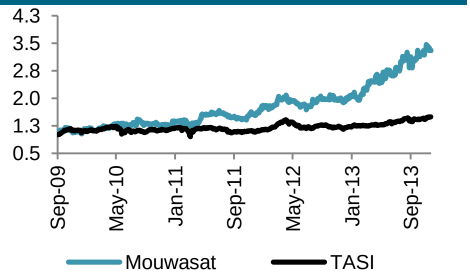
Key Shareholders (%)

Public	47.5
Mr. Mohammed Sultan Al-Subaie	17.5
Mr. Nasser Sultan Al-Subaie	17.5
Mr. Mohammed Bin Suliman Al-Saleem	17.5

Price Multiples

	2013E	2014E
P/E(x)	22.4	18.2
EV/ EBITDA (x)	17.4	14.2
Dividend Yield (%)	2.2	2.7

Mouwasat vs. TASI



Source: Bloomberg

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FINANCIALS

Key ratios	2009	2010	2011	2012	2013E	2014E	2015E
Growth							
Sales	13.9%	13.5%	15.5%	17.4%	12.5%	23.0%	14.0%
EBITDA	11.3%	13.9%	16.4%	9.2%	13.4%	21.4%	13.5%
Net income	10.3%	10.8%	24.9%	15.9%	11.7%	23.0%	14.2%
Total assets	15.8%	23.7%	10.5%	24.4%	16.0%	12.2%	10.4%
Balance Sheet							
Debt/ Equity	24.3%	29.2%	20.7%	33.9%	35.4%	28.1%	23.1%
Working capital/ Sales	-3.8%	-4.4%	3.2%	-3.8%	-0.8%	-1.8%	-2.2%
Capex/ Sales	14.8%	14.3%	13.9%	25.4%	19.5%	12.8%	14.7%
Income Statement							
Gross margin	44.1%	47.2%	47.8%	46.8%	49.7%	48.0%	47.5%
EBITDA margin	30.1%	30.1%	30.4%	28.3%	28.5%	28.1%	28.0%
RoAE	24.1%	22.5%	23.9%	24.0%	23.3%	24.9%	24.6%
RoAA	15.9%	14.7%	15.8%	15.5%	14.5%	15.6%	16.1%
Per Share							
Earnings per share (SAR)	2.14	2.37	2.96	3.43	3.83	4.71	5.38
Dividend per share (SAR)	0.50	1.00	1.50	1.50	1.92	2.36	2.69
Cash per share (SAR)	0.96	2.74	3.85	3.15	3.39	3.68	3.54
Du Pont Analysis							
Average assets (SAR mn)	671	806	938	1,105	1,323	1,508	1,677
Average equity (SAR mn)	444	526	620	716	821	948	1,092
Net income (SAR mn)	107	119	148	172	192	236	269
RoAE	24.1%	22.5%	23.9%	24.0%	23.3%	24.9%	24.6%

Sources: Company reports, Saudi Fransi Capital analysis

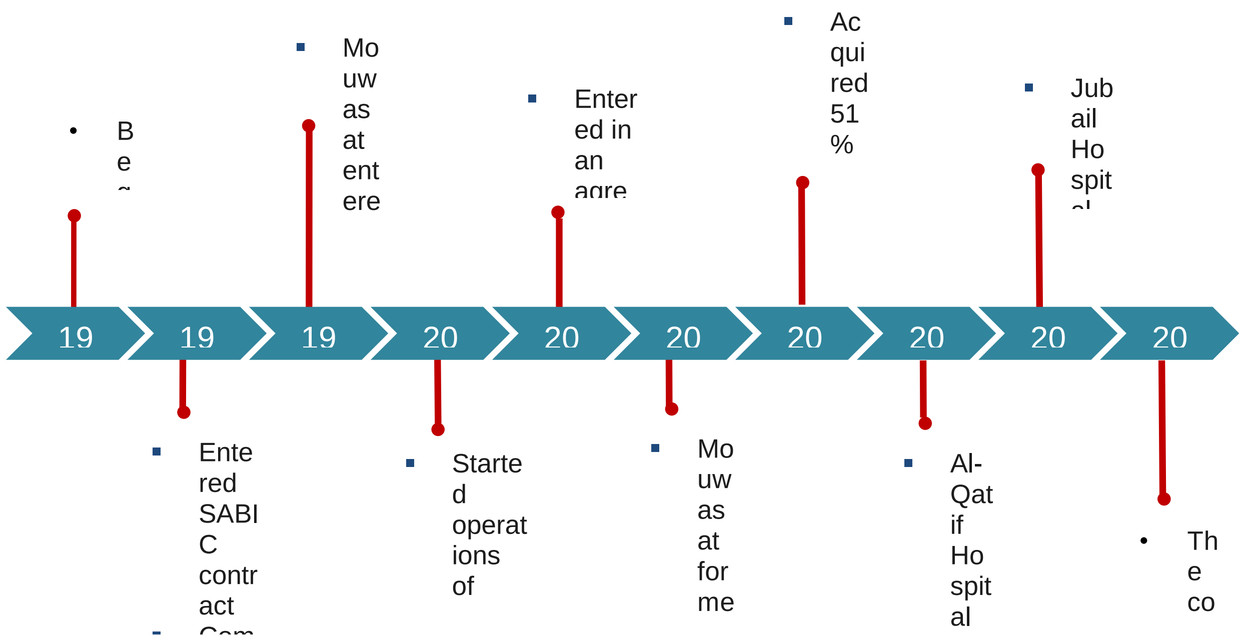
Company Profile

Leader in KSA's healthcare sector

Mouwasat's current capacity stands at 594 beds and 212 outpatient clinics

Mouwasat Medical Services Company (Mouwasat), the largest listed healthcare private player in KSA, commenced operations in 1974. The company established its first dispensary in 1975 in Dammam, with the primary objective of providing healthcare facilities to the vast population. Since then, Mouwasat has emerged as a comprehensive healthcare services provider through a network of hospitals, dispensaries, pharmacies and specialized centers. The company currently operates four hospitals in Dammam, Madinah, Jubail and Qatif with a total bed capacity of 594 and has 212 outpatient clinics. In addition, Mouwasat runs a dispensary in Al-Hasa and has set up pharmacies in Dammam, Khobar, Madinah, Qatif, Jubail and Al-Hasa. The company is also engaged in the management and maintenance of hospitals, medical centers and medicine warehouses. The company's top line increased at a CAGR of 14.7%, while net profit grew 14.1% over 2007–12.

Fig. 23: Mouwasat – Timeline



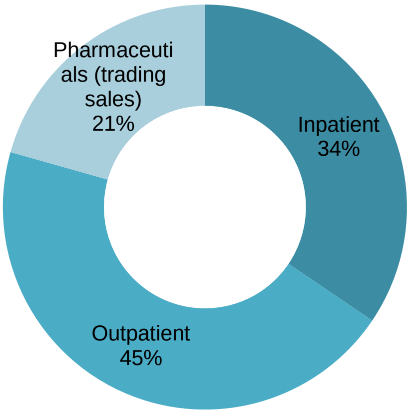
Sources: Company reports, Saudi Fransi Capital analysis

Outpatient and inpatients revenue account for majority of Mouwasat's top-line

Mouwasat primarily operates through three business segments: Inpatient, Outpatient and Pharmaceuticals. Revenue generated from management of hospitals is considered as management fee. While Inpatient and Outpatient divisions mainly include operational revenue generated from hospitals and clinics, the Pharmaceuticals segment comprises revenue generated through sales at pharmacies. In 2012, Outpatient and Inpatient segments accounted for 45% and 34% of total revenue, respectively, while Pharmaceuticals constituted the remaining 21%. Mouwasat's key clientele includes Insurance companies followed by Saudi Aramco, SABIC, Government Organization for Social Insurance (GOSI), and Saudi Electricity Company.

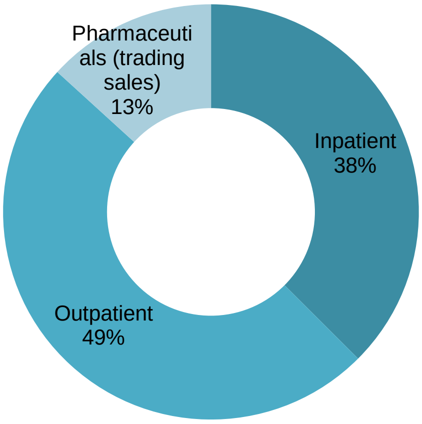
Mouwasat Medical Services

Fig. 24 (A): Segment-wise revenue breakdown, 2012



Sources: Company reports, Saudi Fransi Capital analysis

Fig. 24 (B): Segment-wise gross profit breakdown, 2012

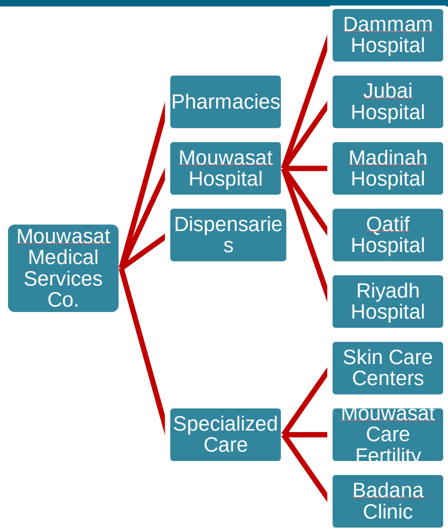


Sources: Company reports, Saudi Fransi Capital analysis

Fig. 24 (C): Capacity details

Hospitals	Year of Establishment	Bed Capacity	Clinics capacity
Hospitals owned by Mouwasat			
Dammam Hospital	1988	240	100
Jubail Hospital	2004	114	48
Madinah Hospital	2000	120	37
Qatif Hospital	2002	120	35

Fig. 24 (D): Organizational structure



Sources: Company reports, Saudi Fransi Capital analysis

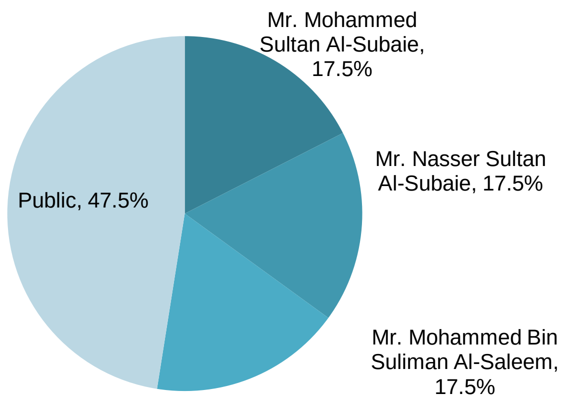
Impressive growth in inpatient and outpatient segment supported 14.7% growth in revenue over 2007-12

The company's revenue increased at a CAGR of 14.7% over 2007–12 due to strong demand for healthcare services in KSA. Outpatient revenue registered a CAGR of 18% as a higher number of people started visiting hospitals with the availability of better diagnostics services. On the other hand, Inpatient revenue expanded at a CAGR of 12% owing to advancements in treatments and better healthcare facilities. Revenue from the Pharmacies segment rose 13% during 2007–12 due to the factors discussed above. Operating and net income increased 14.1% each over the same period. However, as the increase in expenses outpaced the rise in revenue, growth was lower at both the operating and net level.

Shareholder structure

Mouwasat's major shareholders include Mr. Mohammed Sultan Al-Subaie, Mr. Nasser Sultan Al-Subaie and Mr. Mohammed Bin Suliman Al-Saleem, with each accounting for a 17.5% stake.

Fig. 25: Shareholder structure



Sources: Company reports, Saudi Fransi Capital analysis

Management details

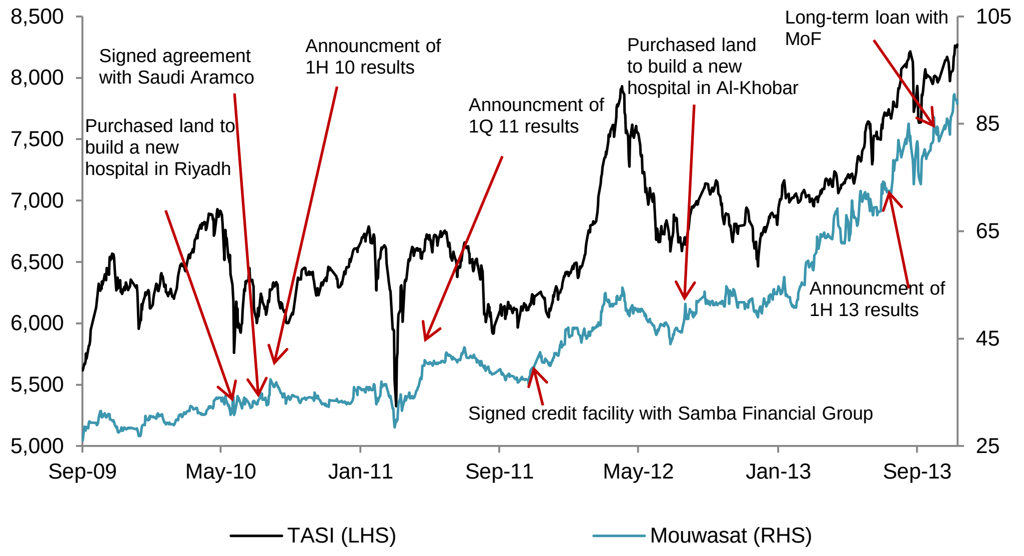
Fig. 26: Key management and board members

Mr. Mohammed Sultan Al-Subaie	Chairman
Mr. Nasser Sultan Al-Subaie	Chief Executive Officer and Vice Chairman
Mr. Mohammed Bin Suliman Al-Saleem	Managing Director
Mr. Khalid Suliman Al-Saleem	Deputy Managing Director
Mr. David Price	Board Member
Mr. AbdulAziz Saad Al-Mangoor	Board Member
Mr. Ibrahim Hamad Al-Babtain	Board Member

Sources: Tadawul, Saudi Fransi Capital analysis

Stock price performance

Fig. 27: Mouwasat price vs. TASI



Sources: Tadawul, Saudi Fransi Capital analysis

3Q 2013 results

Mouwasat reported its 3Q 2013 performance on October 27, 2013 with earnings increasing 25% YoY. Net profits for the quarter stood at SAR 44.1mn, 6.6% above consensus estimate. The growth was primarily driven by improvement in capacity utilization levels which led to 13% growth in revenue supported by higher inpatient and outpatient revenue. Gross margins and operating margins improved 444bps and 327bps, respectively. However, the QoQ performance was impacted by decline in the revenue as a result of lower inpatient and outpatient visits during the Ramadan and summer vacation.

Fig. 28: Result snapshot

In SAR mn, unless specified	3Q 2012	2Q 2013	3Q 2013	QoQ change	YoY change
Revenue	187.3	228.7	211.6	(7.5%)	13%
Gross profit	84.0	116.9	104.3	(10.8%)	24%
Gross margin (%)	44.8	51.1	49.3		
Operating profit	37.1	60.0	48.8	(18.7%)	32%
Operating margin (%)	19.8	26.2	23.1		
Net income	35.4	54.2	44.1	(18.6%)	25%

Sources: Tadawul and Saudi Fransi Capital analysis

Valuation Analysis

Target price: SAR 102/share; Recommendation BUY

Mouwasat is valued using a combination of fundamental and relative valuation techniques. For fundamental valuation, we used the Discounted Cash Flow (DCF) method is deployed. For the relative valuation approach, Price-to-Earnings and Enterprise Value-to-EBITDA multiples have been used.

Fig. 29: Blended Valuation

	Target price	Weights
DCF valuation	111.2	50%
EV/EBITDA multiple	98.4	25%
P/E multiple	86.2	25%
Weighted average target price	101.8	
Upside/downside from current market price	*18.6%*	

Source: Saudi Fransi Capital analysis

DCF valuation

Our DCF model is based on a five-year explicit forecast period until 2018. DCF valuation of Mouwasat yielded a fundamental value of SAR 111.2/share. The company's consolidated DCF is presented in the table below.

Fig. 30: Discounted Cash Flow Summary

In SAR mn	2013E	2014E	2015E	2016E	2017E	2018E
EBIT * (1-t)	202,264	249,820	285,239	318,582	355,535	422,740
Add: Depreciation and amortization	42,984	47,587	52,206	59,075	65,710	71,959
Changes in working capital	(6,925)	(19,928)	(27,190)	(10,097)	(10,388)	(25,268)
Capital expenditure	(174,400)	(140,628)	(184,359)	(178,089)	(167,710)	(92,612)
Free Cash flow to Equity	**63,924**	**136,851**	**125,895**	**189,470**	**243,146**	**376,819**
Present value of the free cash flow	63,377	124,364	104,866	144,625	170,117	241,653
Terminal value						7,685,469
PV of future cash flows						785,626
PV of terminal value						4,928,673
Total Enterprise Value						**5,714,299**
Add: Cash & equivalents						247,778
Less: Debt						(311,268)
Less: Other liabilities						(34,326)
Less: Minority interest						(55,271)
Equity value						**5,561,212**
Number of shares (mn)						50,000
Target price per share						**SAR 111.2**

Source: Saudi Fransi Capital analysis

Valuation sensitivity to WACC and Terminal growth rate

Our DCF valuation is based on a weighted average cost of capital (WACC) of 9.1% and long-term growth rate of 4.0%. The derived WACC is based on a cost of equity of 9.7% and a post-tax cost of debt of 1.4%. For our valuation, we calculated WACC assuming an equity-to-debt ratio of 93-to-7.

Fig. 31: Sensitivity to WACC and terminal growth rate assumption

		Terminal growth rate				
		2.0%	**3.0%**	**4.0%**	**5.0%**	**6.0%**
WACC	**7.1%**	120.0	147.2	191.9	279.4	525.9
	8.1%	97.9	115.5	141.7	184.8	269.0
	9.1%	82.1	94.3	111.2	136.5	178.0
	10.1%	70.3	79.1	90.8	107.2	131.5
	11.1%	61.1	67.7	76.2	87.5	103.3

Source: Saudi Fransi Capital analysis

Relative valuation

With 2014 P/E and EV/EBITDA multiples of 18.2x and 14.2x (respectively), Mouwasat is trading broadly in line with its KSA peers

For a market approach-based relative valuation of Mouwasat, we used P/E and EV/EBITDA multiples, which we believe were most suitable for the purpose. We selected a peer group of healthcare service providers operating within the GCC region, Middle East and Africa (MEA), and global healthcare providers. We expect Mouwasat's multiples to trade in line with the market capital-weighted average valuation multiples of the KSA peer group. We have assigned Mouwasat target P/E and EV/EBITDA multiples of 18.3x and 14.0x, respectively. Our comparative valuation is summarized in the following table.

Fig. 32: Relative valuation

	Market Cap (USD mn)	Price/Earnings (x)			EV/ EBITDA (x)		
Company		**2012**	**2013E**	**2014E**	**2012**	**2013E**	**2014E**
Mouwasat	1,147	25.1	22.4	18.2	19.5	17.4	14.2
Dallah Health	850	23.9	25.6	18.5	16.5	18.9	13.7
National Medical Care	652	23.3	23.2	18.0	18.2	16.9	14.3
Medicare Group	423	22.4	NA	NA	14.2	NA	NA
NMC Health PLC	1,197	9.3	17.5	16.8	7.8	13.8	12.4
Life Healthcare Group	4,086	22.6	23.6	20.4	12.8	13.3	11.8
Netcare	3,527	18.8	17.6	14.9	10.6	10.6	9.9
Fortis Healthcare	781	64.0	8.3	NA	21.1	12.0	22.9
Bangkok Chain Hospital PCL	495	19.7	24.1	20.4	12.9	14.2	12.4
Ramsay Health care Ltd	7,218	20.1	28.9	24.9	11.0	14.5	12.8
MCap weighted average multiple for Saudi Arabia (Ex- Mouwasat)		**23.6**	**24.5**	**18.3**	**17.2**	**18.0**	**14.0**
MCap weighted average multiple for MEA		**20.0**	**20.2**	**17.1**	**12.2**	**12.6**	**11.1**
MCap weighted average multiple for Global		**21.8**	**23.1**	**19.4**	**12.1**	**13.3**	**12.2**

Sources: Bloomberg, Saudi Fransi Capital analysis

Forecast Assumptions

Revenue expected to benefit from hospital expansions

Capacity expansions at strong demand centers to add potentially to revenues over the forecast period

We expect Mouwasat's revenue to rise 15.1% over 2012–18E, primarily driven by the company's expansion initiatives. While strong demand dynamics for healthcare services are a fundamental positive, the company's expansion plans in the Eastern and Western regions place it well to tap this growth potential. The company aims to establish a new hospital in Riyadh with a capacity of 175 beds and 60 outpatient clinics. We believe this facility would become operational in 1Q 2014, based on our discussion with management. Mouwasat also plans to open a new hospital in Al-Khobar with a capacity of 220 beds and 50 outpatient clinics, which is likely to be operational by 1Q 2018. The company is also expanding its Jubail hospital capacity by 100 beds, which would raise its total capacity to 214 beds by 1Q 2015. Mouwasat's total bed capacity is expected to reach 1,089 beds in 2018 after these additions. Considering about 60% of the KSA's population resides in these regions, we believe the company stands to gain in terms of incremental business as demand for healthcare services is on the rise.

To forecast outpatient revenue, we have assumed that each outpatient clinic would be operating for 360 days in a year and 30 patients would visit each clinic every day. We have assumed a 3–3.5% admission ratio for inpatient department over the forecast period.

Fig. 33: Revenue

In SAR mn	2012	2013E	2014E	2015E	2016E	2017E	2018E
Total revenue	**797**	**896**	**1,103**	**1,257**	**1,402**	**1,554**	**1,852**
YoY growth		*12.5%*	*23.0%*	*14.0%*	*11.5%*	*10.9%*	*19.2%*
Inpatient							
Revenue	275	341	449	543	630	721	913
YoY growth		*24.0%*	*31.8%*	*20.9%*	*16.1%*	*14.5%*	*26.5%*
Capacity (beds)	594	594	769	869	869	869	1,089
Utilization	*49.3%*	*48.6%*	*43.7%*	*44.8%*	*45.9%*	*47.0%*	*45.4%*
Admission rate	*2.9%*	*3.0%*	*3.1%*	*3.2%*	*3.3%*	*3.3%*	*3.5%*
Outpatient							
Revenue	358	384	475	528	577	629	726
YoY growth		*7.5%*	*23.5%*	*11.1%*	*9.3%*	*9.0%*	*15.5%*
Capacity (clinics)	212	212	272	272	272	272	322
Utilization	*63.5%*	*60.5%*	*55.5%*	*59.0%*	*62.0%*	*65.0%*	*61.0%*
Pharmacy							
Revenue	164	171	179	187	195	204	213
YoY growth		*4.2%*	*4.5%*	*4.5%*	*4.5%*	*4.5%*	*4.5%*

Source: Saudi Fransi Capital analysis

In 3Q 2013, the outpatient segment accounted for a majority of Mouwasat's total revenues at 43%. The inpatient segment account for 38% of total revenue, whereas pharmacy contributes 18%. However, as the company's bed capacity increases over time, we expect higher admission rates and utilization levels to result in 22.2% CAGR in the inpatient segment's revenue during 2012–18. Revenues of the outpatient and pharmacy segments are likely to record a CAGR of 12.5% and 4.4%, respectively, over the same period. As a result, we expect the inpatient revenue share in the total revenue to reach 49% by 2018. Outpatient and pharmacy contribution to total revenue is expected to be 39% and 12%, respectively.

Margins expected to grow marginally over 2012-18E

Operating margins to reach 24% by 2018 from 23.4% in 2012

We expect operating margins to improve by 60bps, reaching 24.0% in 2018 from 23.4% in 2012. Direct cost is expected to register a CAGR of 14.5% over the forecast period, primarily due to increase in the staff cost incurred for new hospital operations and expansions. On the other hand, selling and distribution expenses and other administrative expenses are expected to record a 16.0% CAGR over 2012–18, driven by higher expense on marketing and promotion that Mouwasat would be required to incur on new hospitals advertising.

We expect Mouwasat's net profit to record a CAGR of 15.0%, reaching SAR 397mn in FY18. We have assumed an effective tax rate of 6% over our forecast period based on the historical trend wherein the company's effective tax rate has remained in the range of 4.3–9.8%.

Fig. 34: Gross and net profits

In SAR mn	2012	2013E	2014E	2015E	2016E	2017E	2018E
Gross profit	**373**	**446**	**530**	**597**	**673**	**752**	**898**
YoY growth		*19.6%*	*18.8%*	*12.8%*	*12.6%*	*11.8%*	*19.4%*
Gross margin	*46.8%*	*49.7%*	*48.0%*	*47.5%*	*48.0%*	*48.4%*	*48.5%*
Operating profit	186	212	262	299	334	373	444
YoY growth		*14.1%*	*23.5%*	*14.2%*	*11.7%*	*11.6%*	*18.9%*
Operating margin	*23.4%*	*23.7%*	*23.8%*	*23.8%*	*23.9%*	*24.0%*	*24.0%*
Net profit	172	192	236	269	300	334	397
YoY growth		*11.7%*	*23.0%*	*14.2%*	*11.5%*	*11.5%*	*18.6%*
Net margin	*21.5%*	*21.4%*	*21.4%*	*21.4%*	*21.4%*	*21.5%*	*21.4%*

Source: Saudi Fransi Capital analysis

Debt levels and capital expenditure

Mouwasat to incur SAR 780mn capital expenditure for the development of new hospitals and existing capacity expansions

We believe Mouwasat has incurred capital expenditure of around SAR 330mn for the construction of Riyadh Hospital over 2012–13. Based on the management discussion, we believe 50% of this expenditure is funded by the Ministry of Finance (MoF) interest free loan, 25% of the requirement will be met through internal sources, and the remaining from commercial bank loans. The company is likely to expend another SAR 360mn for constructing the Al-Khobar facility during 2014–17 and SAR 90mn for the Jubail hospital expansion over 2012–14. We believe the company's strong cash from operations (c.SAR 185mn in 3Q 2013), coupled with the financial assistance from MoF, place Mouwasat in a comfortable position, allowing it to not only services its debt obligation but also maintain healthy dividend payments to shareholders. In 2018, we expect Mouwasat to report net cash of SAR 272mn compared to a net debt of SAR 101mn in 2012 as the debt levels reduce and all the capital expenditure incurred over 2012–17 start being accretive to the earnings.

Dividend payment

We have assumed Mouwasat to maintain a dividend pay-out ratio of approximately 50% over our forecast period. Dividend yields are expected to remain in the range of 2.2–4.6%.

FINANCIALS

Income Statement (SAR mn)	2009	2010	2011	2012	2013E	2014E	2015E
Revenues	**518**	**587**	**678**	**797**	**896**	**1,103**	**1,257**
Direct costs	(290)	(310)	(354)	(424)	(450)	(573)	(660)
Gross profit	228	277	324	373	446	530	597
Operating expenses	(107)	(134)	(155)	(187)	(233)	(267)	(298)
Operating income	121	143	169	186	212	262	299
EBITDA	156	177	206	225	255	310	352
Finance charges, net of Other income	(3)	(4)	6	8	9	7	8
Non-controlling interests	(7)	(12)	(12)	(13)	(17)	(19)	(22)
Net income before Zakat	112	127	164	180	205	251	286
Zakat	(5)	(8)	(16)	(9)	(13)	(15)	(17)
Net income	**107**	**119**	**148**	**172**	**192**	**236**	**269**
EPS (SR)	2.14	2.37	2.96	3.43	3.83	4.71	5.38

Balance sheet (SAR mn)	2009	2010	2011	2012	2013E	2014E	2015E
Cash and cash equivalents	48	137	193	158	169	184	177
Short term investments	0	0	0	70	100	100	100
Accounts receivable and prepayments	177	177	183	222	231	284	314
Inventories	50	50	59	63	75	87	95
Total current assets	**275**	**396**	**435**	**512**	**575**	**654**	**687**
Non-current assets	445	495	550	713	846	940	1,073
Total assets	**720**	**891**	**985**	**1,225**	**1,421**	**1,594**	**1,760**
Accounts payable, accruals and Zakat provisions	82	94	108	121	136	180	192
Total debt	116	167	138	259	311	286	269
End of services indemnities	19	23	27	31	36	41	50
Total liabilities	**217**	**284**	**274**	**412**	**483**	**507**	**511**
Shareholders' equity	480	572	669	764	879	1,017	1,167
Non-controlling interests	24	36	42	50	59	69	81
Total liabilities and shareholders' equity	**720**	**891**	**985**	**1,225**	**1,421**	**1,594**	**1,760**

Cash flow (SAR mn)	2009	2010	2011	2012	2013E	2014E	2015E
Net cash from operating activities	129	144	222	193	246	284	321
Purchase of property and equipment	(77)	(84)	(94)	(203)	(174)	(141)	(184)
Net cash used in investing activities	(78)	(80)	(83)	(267)	(202)	(139)	(182)
Debt	3	50	(28)	121	52	(26)	(16)
Dividend paid	(35)	(25)	(50)	(75)	(75)	(96)	(118)
Net cash from (used in) financing activities	(32)	25	(83)	40	(32)	(131)	(146)
Net change in cash and cash equivalents	**19**	**89**	**56**	**(35)**	**12**	**14**	**(7)**
Cash & cash equivalents at the beginning of the period	29	48	137	193	158	169	184
Cash & cash equivalents at the end of the period	**48**	**137**	**193**	**158**	**169**	**184**	**177**

Sources: Company reported, Saudi Fransi Capital analysis

Dallah Healthcare Holdings

Healthcare | November 26, 2013

Dallah – Riding on expansion spree

- **Focus on specialized services:** In 2011, Dallah Healthcare Holdings (Dallah), a strong contender in the healthcare industry, accounted for c.3% of bed capacity provided by private players and c.2% of total patient flow in private sector hospitals in the KSA. The company's operations are focused on Riyadh, the KSA's commercial hub and home to 25% of the Kingdom's total population. Dallah's focus on providing specialized care through a team of reputed and qualified physicians has enabled it to generate the 2nd highest per-patient revenues next to Care. Moreover, the company's strong brand equity is apparent via the high utilization levels of Dallah's hospitals and clinics (c.77%) versus about 50 to 65% reported by the other listed private players.

- **New projects further strengthen presence in specialized services:** Dallah plans to open a new children's hospital in Riyadh by the end of 2013. The facility is expected to have 70 beds in total, which will increase the company's total bed capacity by ca.19% to 447 beds in 2013, with a total investment of SAR 88mn. Furthermore, the company aims to add another 65 clinics to the Dallah Hospital Outpatient department in 4Q 2014. In 2017, Dallah aims to initiate operations of a new hospital in West Riyadh with a total bed capacity of 300 beds and 80 outpatient clinics at a total investment of SAR 500mn. We expect the development of these capacities to account for c.69% of growth in revenue (CAGR of ca.20.6% during 2012 to18). While the company currently intends to focus on a single geographic segment alone, i.e. Riyadh, where it enjoys strong brand loyalty, we believe Dallah's expansion of specialized services which command higher prices could further support improvement in revenue.

- **Strong pharmacy margins, coupled with favorable pricing, to aid margin improvement:** Dallah's pharmacy segment commands the highest gross margins (c.33% in 3Q 2013) relative to its healthcare peers; which can be attributed to the wholesale distribution of its high-margin herbal and cosmetics products. Additionally, higher per-patient revenues due to the specialized services contribute to stronger pricing (ca.8% CAGR growth during 2012–18). We expect these factors to limit the effect of high staff costs and low utilizations on Dallah's operating margins during the initial stages of new hospital operations. We also anticipate margins to increase from 20.6% in 2012 to 23.1% in 2018 on improving utilization levels, stronger pricing and benefits of scale.

- **Valuation appears nearly full; recommend HOLD with a target price of SAR 70/share:** Dallah represents an opportunity to invest in the KSA's healthcare sector considering its focus on offering specialized services and overall growth strategy. We forecast that the company's will maintain a dividend payout ratio of ca.50% during the 2013 to18 period owing to strong operating cash flows as planned capital expenditure begins to contribute meaningfully to the top and bottom lines. This could raise Dividend Yields from 2.2% in 2012 to 4.0% in 2018. At a P/E multiple of 18.5x for 2014, the stock is trading at slight premium to KSA (18.1x) and at discount to global peers (19.4x) and appears nearly fully priced at current levels. A blended valuation approach (comprising of Discounted Cash Flow Analysis and a Relative Valuation methodology based on P/E and EV/EBITDA multiples) results in a target price of SAR 70/share (+3.7% from current levels). Key upside risks include higher utilization levels and better-than-expected pricing power. Primary downside risks to our target price include possible delays in the initiation of operations for new hospitals as well as labor costs.

Rating Summary

Recommendation	**HOLD**
Target price (SAR)	**70**
Upside/(Downside)	**3.7%**

Stock Details

Current Price*	SAR	67.5
Market Capitalization	SAR Mn	3,186
Shares Outstanding	Mn	47.2
52-Week High	SAR	96.8
52-Week Low	SAR	51.0
Price Change (YTD)	%	2.7%
EPS 2014E	SAR	3.6
Ticker (Reuters/ Bloomberg)	4004.SE	DALLAH AB

* *Price as of November 25, 2013*

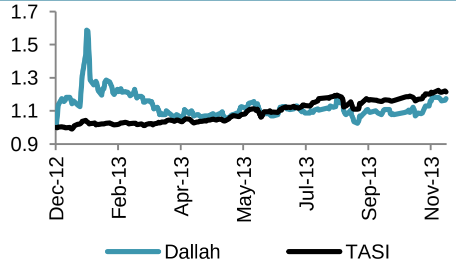
Key Shareholders (%)

Dallah Baraka Holding Company	51.7
Mr. Mr. Mohammed Rashid Al Faqih	5.2
Mr. Tariq Othman Al Qasabi	5.2
Others	7.8
Public	30.1

Price Multiples

	2013E	2014E
P/E(x)	25.6	18.5
EV/ EBITDA (x)	18.9	13.7
Dividend Yield (%)	2.0	2.7

Dallah vs. TASI



Source: Bloomberg

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FINANCIALS

Key ratios	2009	2010	2011	2012	2013E	2014E	2015E
Key Growth Ratios							
Sales growth	16.9%	8.6%	11.6%	20.8%	17.7%	14.2%	22.8%
EBITDA	4.2%	38.8%	14.9%	29.5%	3.8%	33.1%	28.2%
Net income	-1.8%	66.9%	20.0%	17.6%	-6.7%	38.1%	30.5%
Total assets	7.0%	12.8%	42.0%	82.4%	5.2%	9.6%	11.1%
Balance Sheet Ratios							
Debt/ Equity	0.7%	0.0%	32.9%	0.9%	0.0%	0.0%	0.0%
Working capital/ Sales	-4.3%	-1.4%	-8.8%	-12.6%	-16.0%	-8.6%	-9.9%
Capex/ Sales	5.3%	6.3%	13.7%	13.6%	26.8%	20.6%	17.9%
Income Statement Ratios							
Gross margin	29.9%	35.9%	36.0%	38.2%	43.5%	42.2%	43.2%
EBITDA margin	17.8%	22.7%	23.4%	25.1%	22.1%	25.8%	26.9%
RoAE	19.4%	28.7%	27.5%	16.8%	10.9%	14.0%	16.6%
RoAA	13.4%	20.4%	19.1%	13.5%	9.5%	12.3%	14.5%
Per Share Ratios							
Earnings per share (SAR)	1.20	2.00	2.40	2.83	2.64	3.64	4.76
Dividend per share (SAR)	0.00	0.00	0.00	1.50	1.32	1.82	2.38
Cash per share (SAR)	0.45	1.42	1.80	11.87	0.99	3.33	2.45
Du Pont Analysis							
Average assets (SAR mn)	421	463	594	985	1,306	1,402	1,548
Average equity (SAR mn)	292	329	412	792	1,142	1,224	1,348
Net income (SAR mn)	57	94	113	133	124	172	224
RoAE	19.4%	28.7%	27.5%	16.8%	10.9%	14.0%	16.6%

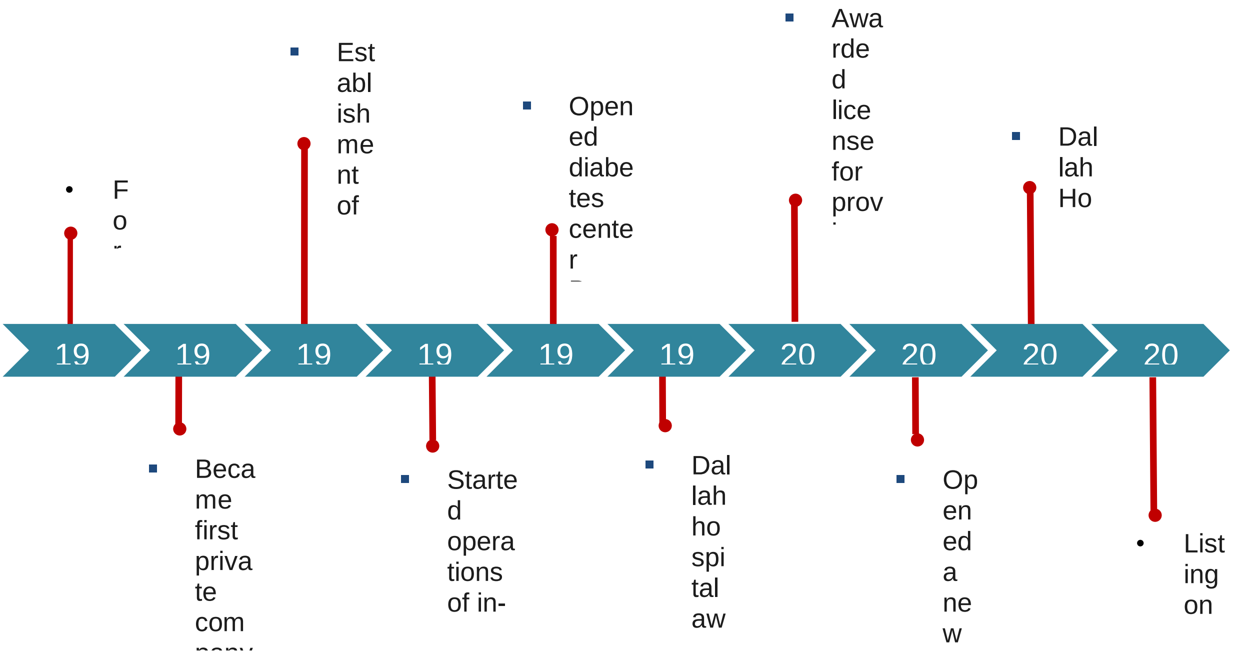
Sources: Company reported, Saudi Fransi Capital analysis

Company Profile

Dallah's revenue increased at a CAGR of 17.1% over 2007-12

Established in 1987 and headquartered in Jeddah, Dallah Healthcare Holding Company (Dallah) is another major healthcare player that was recently listed on the KSA bourse. The company is engaged in the delivery of healthcare services through its subsidiary, Dallah Hospitals, which operates hospitals and clinics in the Kingdom. Dallah operates a hospital in Riyadh with a total capacity of 377 beds. The company is also engaged in the wholesale distribution of pharmaceuticals, herbal and cosmetics products and drugs through Dallah Pharma, a subsidiary. Dallah has exclusive distribution rights for 45 pharmaceutical products, 12 herbal products and 8 cosmetic products. Furthermore, the company manages the operations of hospitals owned by third-parties. Currently, Dallah operates the Muhayl Aseer Hospital and Al Khafi Joint Operational Hospital. In addition, the company has invested in Mecca Medical Services, Al Ahsa Medical Services and Jordanian Pharmaceuticals Manufacturing Company. Over 2007–12, the company's revenue increased at a CAGR of 17.1%, due to the strong demand potential in Saudi Arabia.

Fig. 35: Dallah – Timeline

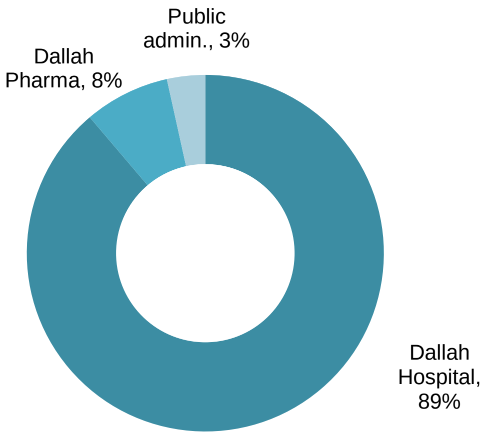


Sources: IPO Prospectus, Saudi Fransi Capital analysis; JCI = Joint Commission International

Hospital segment accounts for majority of Dallah's top-line

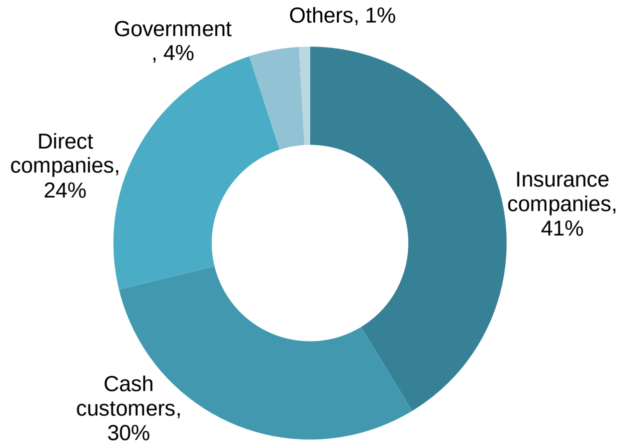
In 2012, Dallah generated about 89% of revenue from the Hospitals segment, which includes outpatient and inpatient revenue. Pharmaceuticals contributed 8%, while the Public Administration segment accounted for the remaining 3%. The company's clientele primarily includes cash customers, insured customers and company-sponsored customers. While cash customers consist of patients who pay for their treatment themselves (represented 20% of outpatients and 38% of inpatients in 2011), insured customers include patients whose cost of treatment is borne by insurance companies (62% of outpatients and 54% of inpatients in 2011). Company-sponsored patients are those whose cost of treatment is borne by employers; they represented 18% of outpatients and 9% of inpatients during the same period.

Fig. 36 (A): Segment-wise revenue breakdown, 2012



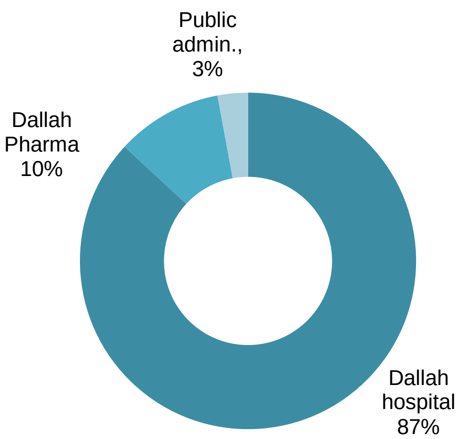
Sources: Company reports, Saudi Fransi Capital analysis

Fig. 36 (B): Customer-wise revenue breakdown, 2011



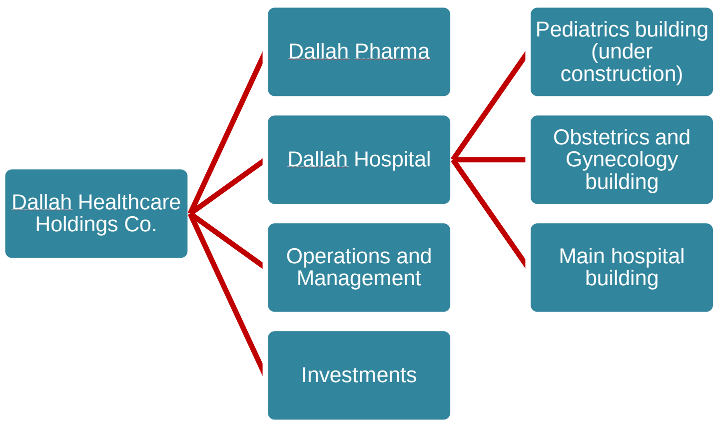
Sources: Company reports, Saudi Fransi Capital analysis

Fig.36 (C):Segment-wise gross profit breakdown, 2012



Sources: Company reports, Saudi Fransi Capital analysis

Fig. 36 (D):Organizational structure



Sources: Company reports, Saudi Fransi Capital analysis

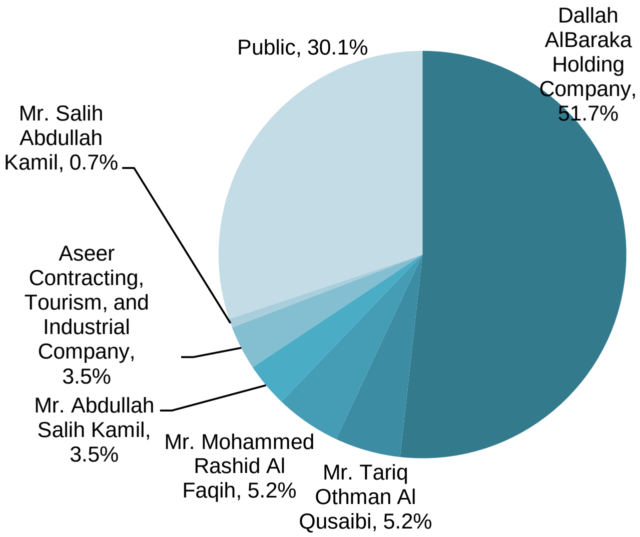
Growing inpatient and outpatients visits has driven revenue growth over 2007-12

Dallah's revenue increased at a CAGR of 17.1% on strong growth in Hospital revenues. With an improvement in diagnostics and the availability of better treatments, the number of patients visiting hospitals has expanded significantly. Consequently, there was a rise in inpatient and outpatient revenue that, in turn, resulted in the 16.6% growth in hospital revenue during 2007–12. In addition, the Pharmaceutical segment's revenue grew 13% with an increase in the number of pharmacies and higher demand for medicines. Dallah's operating income surged 32.6% over 2007–12 due to strong pricing and high utilization levels. However, the growth at net income level declined marginally on an increase in interest expenses and the company reported a CAGR of 32.1%during the same period.

Shareholder structure

Dallah's major shareholders include Dallah AlBaraka Holding Company (52%), Mr. Tariq Othman Al Qusaibi (5%) and Mr. Mohammed Rashid Al Faqih (5%).

Fig. 37: Shareholder structure



Sources: Tadawul, Saudi Fransi Capital analysis

Management details

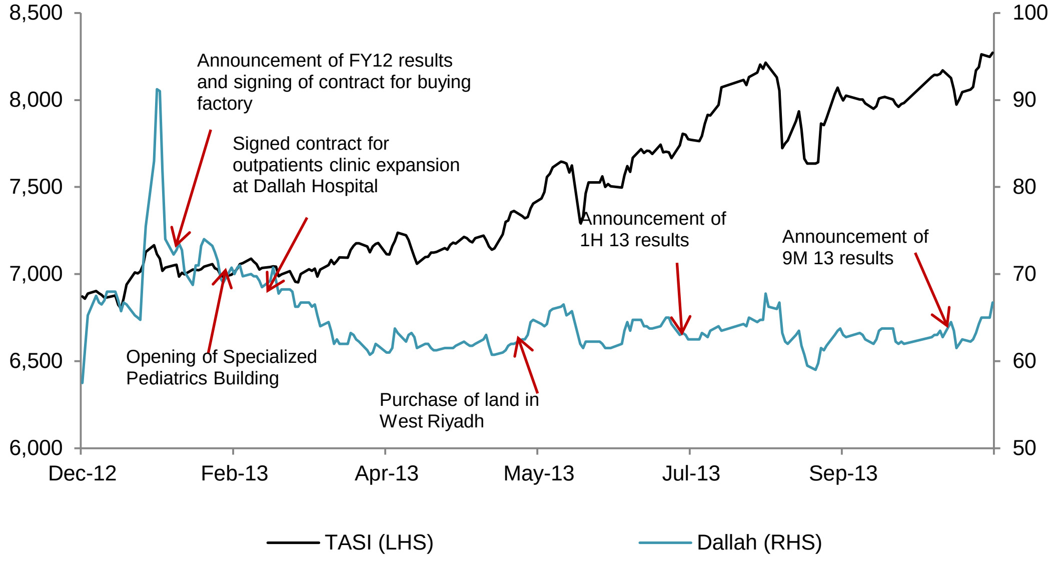
Fig. 38: Key management and board members

Dr. Mohammed Rashid Al Faqih	Medical Superintendent
Dr. Ahmad Saleh Babaeer	Chief Executive Officer and GM, Dallah Hospital
Dr. Saleh Rashed Al Faqih	Advisor on Medical Affairs
Mr. Khalid Saudi	Chief Financial Officer
Dr. Khalid Abd-Rezzak Al Hassan	Medical Director, Dallah Hospital
Eng. Tawfiq Ibrahim Alabdulmughni	GM, Operations and Management
Mr. Ibrahim Ahmad Bahri	GM, Dallah Pharma
Mr. Tarek Osman AlKasabi	Chairman of the Board
Dr. Mohammed Rashid Al Faqih	Board Member
Mr. Ammar Hasan Kamel	Board Member
Mr. Mohiuddin Saleh Kamel	Board Member
Mr. Fahad Siraj Malaikah	Board Member
Dr. Abdulrahman Abdulaziz Al Sawailem	Board Member
Dr. Ahmad Saleh Babaeer	Member of the Board/Chief Executive Officer
Mr. Fahad Abdullah Al Gassem	Board Member
Mr. Faris Ibrahim Al Humaid	Board Member

Sources: Tadawul, Saudi Fransi Capital analysis

Stock price performance

Fig. 39: Dallah price Vs TASI



Sources: Tadawul, Saudi Fransi Capital analysis

3Q 2013 results

Dallah reported 9% YoY decline in net profit during 3Q 2013 which came in 19% below the consensus expectations. Revenue and gross profits reported 17% and 13% YoY increase supported by higher patient flow in 3Q 2013. However bottom-line was impacted due to rise in operating expenses, which we believe could be on account of the soft opening of Children hospital, based on our management discussion. The QoQ was primarily impacted by slower business as patients flow to the hospitals decline on account of Ramadan holidays and summer vacations.

Fig. 40: Result snapshot

In SAR mn, unless specified	3Q 2012	2Q 2013	3Q 2013	QoQ change	YoY change
Revenue	142.3	187.8	167.1	(11.0%)	17%
Gross profit	59.0	80.7	66.7	(17.3%)	13%
Gross margin (%)	41.5	43.0	39.9		
Operating profit	22.4	30.2	21.9	(27.5%)	(2%)
Operating margin (%)	15.8	16.1	13.1		
Net income	23.9	23.6	21.8	(7.6%)	(9%)

Sources: Tadawul, Saudi Fransi Capital analysis

Valuation Analysis

Target price at SAR 70/share; recommendation: HOLD

We valued Dallah using a combination of fundamental and relative valuation techniques. For fundamental valuation, we used the discounted cash flow (DCF) method. For relative valuation, we relied on price-to-earnings, and enterprise value-to-EBITDA multiples.

Fig. 41: Blended valuation

	Target price	Weights
DCF valuation	**72.6**	**50%**
EV/EBITDA multiple	**70.1**	**25%**
P/E multiple	**66.1**	**25%**
Weighted average target price	**70.4**	
Upside/downside from current market price	*3.7*	

Source: Saudi Fransi Capital analysis

DCF valuation

Our DCF model is based on a five-year explicit forecast period from 2013 to 2018. DCF valuation yielded a fundamental value of SAR 72.6/share. The company's consolidated DCF is presented in the table below.

Fig. 42: Discounted cash flow valuation summary

In SAR mn	2013E	2014E	2015E	2016E	2017E	2018E
EBIT * (1-t)	126,443	176,021	230,268	275,689	349,968	435,629
Add: Depreciation and amortization	35,042	38,653	44,694	54,889	59,829	65,011
Changes in working capital	(93,231)	(25,367)	(47,017)	(37,230)	(105,304)	(72,618)
Capital expenditure	(200,864)	(176,391)	(188,112)	(271,657)	(96,392)	(97,774)
Free Cash flow to Equity	**(132,610)**	**12,915**	**39,833**	**21,691**	**208,101**	**330,248**
Present value of the free cash flow	(131,251)	11,514	31,989	15,686	135,562	193,785
Terminal value						4,895,660
PV of future cash flows						388,536
PV of terminal value						2,872,707
Total Enterprise Value						**3,261,243**
Add: Cash & equivalents						280,389
Less: Debt						56,640
Less: Other liabilities						57,393
Equity value						**3,427,600**
Number of shares (mn)						47,200
Target price per share						**SAR 72.6**

Source: Saudi Fransi Capital analysis

Valuation is sensitive to WACC and Terminal growth rate

Our DCF valuation is based on a WACC of 11.0% and a long-term growth rate of 4.0%. The derived WACC is based on cost of equity of 11.1% and post-tax cost of debt of 6.6%. For the valuation, we calculated WACC assuming an equity-to-debt ratio of 98-to-2.

Fig. 43: Sensitivity to WACC and terminal growth rate assumptions

		Terminal growth rate				
		2.0%	**3.0%**	**4.0%**	**5.0%**	**6.0%**
WACC	**9.0%**	77.9	89.6	105.8	130.2	170.8
	10.0%	66.8	75.2	86.4	102.1	125.6
	11.0%	58.2	64.5	**72.6**	83.4	98.5
	12.0%	51.4	56.3	62.3	70.1	80.6
	13.0%	45.9	49.7	54.4	60.2	67.8

Source: Saudi Fransi Capital analysis

Relative valuation

With 2014 P/E of 18.5x, Dallah is trading at a premium to its KSA peers

For the market approach-based relative valuation of Dallah, we used P/E and EV/EBITDA multiples, which we believe are most suited for this purpose. We selected a peer group of healthcare service providers that operate within GCC, the Middle East, and Africa (MEA) as well as global healthcare providers. The company's strong fundamentals, coupled with the scope for enhancement of margins relative to its peers, boost our confidence. On a conservative note, we expect Dallah to trade in line with its KSA peer group. We have assigned target P/E and EV/EBITDA multiples of 18.1x and 14.2x, respectively to Dallah. Our comparative valuation is summarized in the following table.

Fig. 44: Relative valuation

	Market Cap (USD mn)	Price/Earnings (x)			EV/ EBITDA (x)		
Company		**2012**	**2013E**	**2014E**	**2012**	**2013E**	**2014E**
Dallah Health	849.6	23.9	25.6	18.5	16.5	18.9	13.7
Mouwasat	1,147	25.1	22.4	18.2	19.5	17.4	14.2
National Medical Care	652	23.3	23.2	18.0	18.2	16.9	14.3
Medicare Group	423	22.4	NA	NA	14.2	NA	NA
NMC Health PLC	1,197	9.3	17.5	16.8	7.8	13.8	12.4
Life Healthcare Group	4,086	22.6	23.6	20.4	12.8	13.3	11.8
Netcare	3,527	18.8	17.6	14.9	10.6	10.6	9.9
Fortis Healthcare	781	64.0	8.3	NA	21.1	12.0	22.9
Bangkok Chain Hospital PCL	495	19.7	24.1	20.4	12.9	14.2	12.4
Ramsay Health care Ltd	7,218	20.1	28.9	24.9	11.0	14.5	12.8
MCap weighted average multiple for Saudi Arabia (Ex- Dallah)		**24.4**	**22.7**	**18.1**	**19.1**	**17.2**	**14.2**
MCap weighted average multiple for GCC		**20.2**	**20.0**	**17.1**	**12.6**	**12.6**	**11.2**
MCap weighted average multiple for MEA		**21.9**	**22.9**	**19.4**	**12.4**	**13.3**	**12.3**

Sources: Bloomberg, Saudi Fransi Capital analysis

Forecast Assumptions

Expansion plans to aid revenue momentum

Expansion plans to result in revenue expansion at a CAGR of 20.6% during 2012–18

Dallah's revenues are expected to expand at a CAGR of 20.6% during 2012–18, supported by the expected rise in inpatient and outpatient visits due to planned expansion and strong pricing (c.8% during 2012–18) over the forecast period. Based on our discussion with the management, we believe the company recently initiated soft opening of its new child care division in Dallah Hospital with a capacity of 70 beds. In addition, the company plans to add 65 outpatient clinics at Dallah Hospital, which would become operational by 4Q 2014. Furthermore, Dallah is opening a new hospital in West Riyadh with a capacity of 300 beds and 80 outpatient clinics, which we anticipate to become operational in early 2017. The company's total bed capacity is expected to reach 747 beds by 2018 from 377 in 2012, while it is likely to have 258 outpatient clinics by 2018 from 113 in 2012. Considering Dallah's emphasis on providing specialized care, which generally realizes higher per-patient revenue, as well as the importance of Riyadh in terms of potential demand base (25% of KSA's total population lives in Riyadh), Dallah is expected to benefit significantly in terms of higher revenue.

To forecast outpatient revenue, we assumed each outpatient clinic would operate 360 days a year and 19 patients would visit each clinic every day. We assume a 4–6% admission ratio for the inpatient department over the forecast period.

Fig. 45: Revenue

In SAR mn	2012	2013E	2014E	2015E	2016E	2017E	2018E
Total revenue	**637**	**750**	**857**	**1,052**	**1,209**	**1,607**	**1,955**
YoY growth		*17.7%*	*14.2%*	*22.8%*	*14.9%*	*32.9%*	*21.7%*
Dallah Hospital							
Revenue	566	669	764	944	1,088	1,476	1,813
YoY growth		*18.3%*	*14.1%*	*23.7%*	*15.2%*	*35.6%*	*22.9%*
Inpatient Capacity (beds)	377	447	447	447	447	747	747
Outpatient clinics	113	113	178	178	178	258	258
Utilization	*79.4%*	*83.7%*	*78.2%*	*76.4%*	*82.3%*	*68.6%*	*79.1%*
Admission rate	*4.8%*	*5.4%*	*5.7%*	*5.7%*	*5.7%*	*5.7%*	*5.7%*
Dallah Pharma							
Revenue	49	59	71	85	98	108	119
YoY growth		*19.9%*	*20.0%*	*20.0%*	*15.0%*	*10.0%*	*10.0%*
Public administration							
Revenue	22	21	22	22	23	23	24
YoY growth		*-3.3%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*

Source: Saudi Fransi Capital analysis

Dallah's Hospital segment is the major contributor to revenue at 91%, whereas Pharma and Public Administration contribute 6% and 3%, respectively. However, post the company's expansion plans, we estimate Hospital revenue to improve significantly at a CAGR of 21.4% during 2012–18, benefiting from increased patient visits and strong pricing. In addition, pharmacy revenue is likely to increase at a CAGR of 15.7% during the forecast period, in line with Dallah's expanding product portfolio owing to the new pharmaceutical factory purchased in January 2013 and the growing medical needs of KSA's population. The new factory is expected to manufacture and distribute about 35 licensed products, thereby increasing Dallah's total pharmaceuticals product range to 80 from 45 currently. In contrast, Public Administration revenue is expected to increase

marginally, at 1.1% during 2012–18. Consequently, we expect the Hospital segment's share of total revenue to reach 93% by 2018. Contribution from the Outpatient and Pharmacy segments to total revenue is expected to be 6% and 1%, respectively.

Margins to report healthy growth during 2013–18E due to strong pricing

Operating margins to reach 23.1% by 2018 from 20.6% in 2012

We expect operating margins to improve 250bps to reach 23.1% in 2018 from 20.6% in 2012 as strong pricing boosts revenues at a faster pace than expenses. Direct cost is expected to increase at a CAGR of 18.8% over the forecast period, primarily due to the rise in staff costs and high salary payments incurred for new hospital operations and expansions. However, we expect direct cost, as a percentage of revenue, to reduce 520bps reaching 56.6% by 2018. Additionally, general and administration expenses are likely to increase most at a CAGR of c.27.7% over the forecast period. As a percentage of revenue we expect general and administration expenses to grow 470bps (c.16.2% in 2018) due to discounts offered to customers, coupled with initiatives such as health checkups undertaken to increase outpatient visits. Selling & distribution expenses and other administrative expenses are expected to expand at CAGR of 22.8% during 2013–18 and increase marginally (200bps over the forecast period) as a percentage of sales to reach 1.8% in 2018. The rise would be due to expenses incurred on the promotion of hospital operations.

We estimate Dallah's net profit to expand at a CAGR of 15.8% to reach SAR 321mn in 2018. We assume an effective tax rate of 9% during the forecast period, in line with the current trend.

Fig. 46: Gross and net profits

In SAR mn	2012	2013E	2014E	2015E	2016E	2017E	2018E
Gross profit	**244**	**326**	**362**	**455**	**534**	**690**	**850**
YoY growth		*33.9%*	*10.9%*	*25.7%*	*17.5%*	*29.0%*	*23.2%*
Gross margin	*38.2%*	*43.5%*	*42.2%*	*43.2%*	*44.2%*	*42.9%*	*43.4%*
Operating profit	**131**	**131**	**182**	**238**	**285**	**362**	**451**
YoY growth		*-0.1%*	*39.2%*	*30.8%*	*19.7%*	*26.9%*	*24.5%*
Operating margin	*20.6%*	*17.5%*	*21.3%*	*22.7%*	*23.6%*	*22.5%*	*23.1%*
Net profit	**133**	**124**	**172**	**224**	**234**	**255**	**321**
YoY growth		*-6.7%*	*38.1%*	*30.5%*	*4.2%*	*9.0%*	*25.9%*
Net margin	*20.9%*	*16.6%*	*20.1%*	*21.3%*	*19.3%*	*15.9%*	*16.4%*

Source: Saudi Fransi Capital analysis

Debt levels and capital expenditure

Dallah expected to incur SAR 500mn capital expenditure for the construction of West Riyadh Hospital

Based on our discussions with Dallah's management, the company incurred capital expenditure of SAR 88mn to construct a child care department in Dallah Hospital. Moreover, the company intends to finance about 70% of its SAR 500mn capital expenditure on West Riyadh Hospital through IPO proceeds, and around SAR 50mn from internal accruals. Furthermore, we expect the company to raise a bridge loan of SAR 150mn in 2015-16 to meet its investing needs. We forecast Dallah's cash flows from operations to rise significantly as capacity expansion begins to contribute to revenues, enabling the company to service its debt obligations and finance dividend distributions to shareholders.

Dividend payment

We expect Dallah to maintain a dividend payout ratio of approximately 50% over the forecast period. Dividend yields would remain in the range of 2.0–4.0%.

FINANCIALS

Income Statement (in SAR mn)	2009	2010	2011	2012	2013E	2014E	2015E
Revenues	**435**	**473**	**527**	**637**	**750**	**857**	**1,052**
Direct costs	305	303	337	393	424	495	597
Gross profit	130	170	190	244	326	362	455
Operating expenses	71	81	92	113	195	180	216
Operating income	59	89	98	131	131	182	238
EBITDA	77	107	123	160	166	57	53
Finance charges, net of Other income	1	10	19	4	6	7	8
Net income before Zakat	60	99	117	135	137	189	247
Zakat	3	4	4	2	12	17	22
Net income	**57**	**94**	**113**	**133**	**124**	**172**	**224**
EPS (SR)	1.20	2.00	2.40	2.83	2.64	3.64	4.76
Balance sheet (in SAR mn)							
Cash and cash equivalents	21	67	85	560	47	157	116
Short term investments	0	0	8	0	200	25	0
Accounts receivable and prepayments	136	150	182	229	291	328	392
Inventories	43	36	30	34	71	83	98
Total current assets	**200**	**252**	**306**	**823**	**609**	**593**	**605**
Non-current assets	235	239	392	450	730	874	1,024
Total assets	**435**	**491**	**698**	**1,273**	**1,338**	**1,467**	**1,629**
Accounts payable, accruals and Zakat provisions	96	94	112	103	114	132	156
Total debt	2	0	77	5	0	0	0
End of services indemnities	30	35	40	49	56	56	56
Other non-current liabilities	2	7	0	0	0	0	0
Total liabilities	**132**	**137**	**229**	**157**	**169**	**188**	**212**
Shareholders' equity	303	355	469	1,116	1,169	1,279	1,417
Total liabilities and shareholders' equity	**435**	**491**	**698**	**1,273**	**1,338**	**1,467**	**1,629**
Cash flow (SAR mn)							
Net cash from operating activities	73	126	128	125	77	180	214
Purchase of property and equipment	(23)	(30)	(72)	(86)	(201)	(176)	(188)
Net cash used in investing activities	(23)	(32)	(72)	(86)	(516)	(7)	(170)
Debt	(12)	0	77	(72)	(5)	0	0
Dividend paid	0	0	0	0	(71)	(62)	(86)
Increase in capital	(23)	(47)	(1)	0	0	0	0
Net cash from (used in) financing activities	(40)	(49)	(38)	437	(76)	(62)	(86)
Net change in cash and cash equivalents	**10**	**46**	**18**	**476**	**(514)**	**111**	**(42)**
Cash & cash equivalents at the beginning of the period	11	21	67	85	560	47	157
Cash & cash equivalents at the end	**21**	**67**	**85**	**560**	**47**	**157**	**116**

Sources: Company reported, Saudi Fransi Capital analysis

National Medical Care Company

Healthcare | November 26, 2013

Care – Margin expansion remains key growth driver

- **Margins to expand due to high revenue per patient:** National Medical Care Company (Care) is a recent addition to the Kingdom's listed private sector players. In our healthcare universe, Care is currently the best margin play based on the scope for improvement in operations in the absence of any significant expansion plans. Owing to differentiated service offerings, the company's average Revenue per patient is the highest (SAR 817 in 2012), a distinct positive. Moreover, we expect the company to operate with higher utilization levels by optimally utilizing its existing capacity. Care's operating margins are forecast to expand 460bps over the next five years, better than those of Mouwasat (60bps over 2012–18) and Dallah (250bps over 2012–18).
- **Consolidating presence in Riyadh:** Care's expansion strategy is to consolidate its current position in the Riyadh region (c.2.6% beds market in 2011) as well as differentiate itself in terms of its healthcare service offerings. In line with this, the company is adding 200 beds to the Riyadh National Hospital, raising its capacity from 100 beds to 300 by 4Q 2013 to provide specialized services. We believe the company has incurred capital expenditure of SAR 545mn for this project. The company recently soft-launched the new hospital; however, we expect the capacity addition to start significantly contributing to revenues only from 2Q 2014. Moreover, the company has plans to open four family medical centers, thereby incurring a capital expenditure of SAR 98.4mn. We expect two of these to become operational from 2014.
- **Lack of significant catalyst dampens long-term outlook:** Care is focused on organically improving its operational performance but lack of significant capacity expansion plans vis-à-vis other players in the healthcare services sector tempers our optimism for now. The company's limited capacity vis-à-vis other players would restrict its ability to benefit from the strong demand prospects that the KSA healthcare services sector offers. Nevertheless, considering the cash levels that the company maintains, a potential acquisition could also as a catalyst for Care.
- **Recommend HOLD with a target price of SAR 56/share:** Care's focus on enhancing returns through optimum utilization of existing capacity is likely to result in ca. 13.8% and 17.5% growth in the top and bottom lines, respectively, over 2012 to 2018E. The company's strong financial profile, considering its comfortable cash position with a net cash of SAR 98mn in 3Q 2013, would enable it to maintain a dividend payout ratio of 60% over 2013 to 18E. Care's dividend yield is expected to increase to 7.0% in 2018 from 1.9% in 2012. At a 2014E P/E multiple of 18.0x, the stock is trading at a slight discount to its KSA peers and global peers. The fact that Care lacks a potential catalyst due to the absence of significant capacity expansion plans would limit its growth prospects. We, therefore, initiate coverage on Care with a HOLD rating and a price target of SAR 56/share. Key upside risks include possible announcements around new capacity and higher utilization levels. Primary downside risks include lower-than-expected pricing power.

Rating Summary

Recommendation	HOLD
Target price (SAR)	56.0
Upside/(Downside)	2.8%

Stock Details

Current Price*	SAR	54.5
Market Capitalization	SAR Mn	2,444
Shares Outstanding	Mn	44.9
52-Week High	SAR	200.0
52-Week Low	SAR	49.6
Price Change (Since listing)	%	(55.3%)
EPS 2014E	SAR	3.0
Ticker (Reuters/ Bloomberg)	4005.SE	CARE AB

** Price as of November 25, 2013*

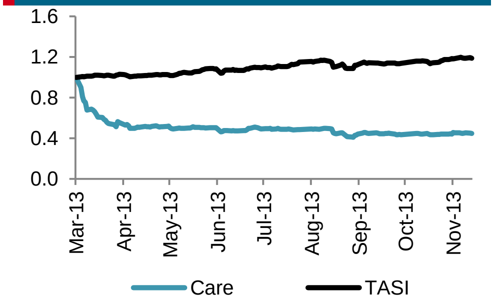
Key Shareholders (%)

Public	38.3
General Organization for Social Insurance (GOSI)	35.1
Fal Holdings	26.6

Price Multiples

	2013E	2014E
P/E(x)	23.2	18.0
EV/ EBITDA (x)	16.9	14.3
Dividend Yield (%)	2.7	3.4

Care vs. TASI



Source: Bloomberg

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National Medical Care Company

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Key ratios	2009	2010	2011	2012	2013E	2014E	2015E
Key Growth Ratios							
Sales growth	24.9%	13.8%	7.5%	14.5%	9.8%	16.9%	12.4%
EBITDA	73.1%	36.7%	13.7%	8.4%	7.0%	18.7%	22.0%
Net income	110.6%	49.5%	11.8%	10.8%	0.4%	29.2%	23.8%
Total assets	17.4%	16.2%	13.0%	16.1%	56.0%	4.1%	-1.1%
Balance Sheet Ratios							
Debt/ Equity	0.0%	0.0%	0.0%	5.2%	29.7%	20.9%	8.0%
Working capital/ Sales	-9.4%	7.3%	-9.5%	-4.0%	-1.5%	-7.7%	-5.4%
Capex/ Sales	7.4%	3.5%	6.4%	4.1%	74.7%	9.5%	9.1%
Income Statement Ratios							
Gross margin	20.3%	24.4%	26.5%	25.8%	22.7%	24.8%	27.0%
EBITDA margin	20.9%	25.1%	26.6%	25.1%	24.5%	24.9%	27.0%
RoAE	14.6%	18.8%	18.2%	18.1%	14.7%	16.0%	18.5%
RoAA	11.7%	15.0%	14.7%	14.2%	10.4%	10.8%	13.1%
Per Share Ratios							
Earnings per share (SAR)	1.26	1.89	2.11	2.34	2.35	3.04	3.76
Dividend per share (SAR)	0.00	0.33	0.64	1.06	1.45	1.87	2.32
Cash per share (SAR)	1.29	2.50	2.00	1.60	6.80	5.18	3.36
Du Pont Analysis							
Average assets (SAR mn)	483	564	645	740	1,017	1,265	1,284
Average equity (SAR mn)	389	452	520	581	718	851	910
Net income (SAR mn)	57	85	95	105	105	136	169
RoAE	14.6%	18.8%	18.2%	18.1%	14.7%	16.0%	18.5%

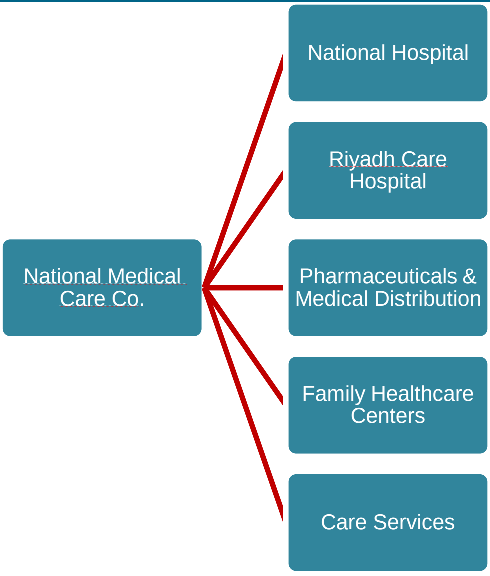
Sources: Company reports, Saudi Fransi Capital analysis

Company Profile

Care operates two hospitals in KSA with a total capacity of 420 beds

Based in Riyadh, the National Medical Care Company (Care) was established in 2003 and got listed on Tadawul in March 2013. The company is engaged in delivery of healthcare services through its two hospitals: National Hospital and Riyadh Care Hospital. National Hospital is the oldest hospital in KSA, with operations dating back to 1967, and has a capacity of 100 beds. Riyadh Care Hospital, located in East Riyadh, was established in 1991 and has capacity of 320 beds. Care is also engaged in Pharmaceutical and Medication Distribution (PMD) along with running Family Healthcare Centers. Over 2008–12, the company's revenue recorded a CAGR of 15.0%, benefiting from strong demand in KSA, increase in services provided to key contracts and expanding in medical specializations.

Fig. 47: Organizational chart



Sources: Company reports, Saudi Fransi Capital analysis

The company generates business from outpatient clinics, inpatients wards, sale of medicines at pharmacies, and distribution and medical drugs and equipment. In 2012, inpatient revenue and the medical divisions accounted for 66% of the total revenue, while the outpatient segment contributed c.12%. The pharmacy segment accounted for c.20% of total revenue and distribution of medical drugs and equipment accounted for the remaining share. Care's key clients include Saudi Aramco, Insurance companies, the General Organization for Social Insurance, Tawuniya, Saudi Electricity Company, and the National Guard Health Affairs.

Fig. 48 (A): Business units gross profit breakdown, 2012

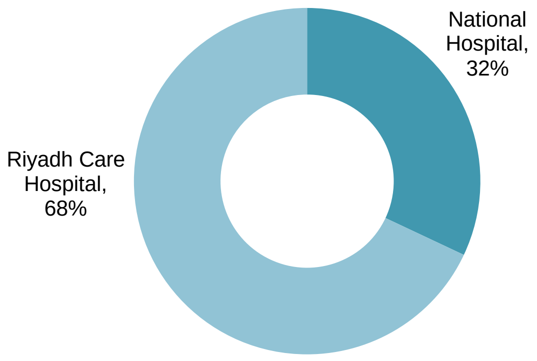
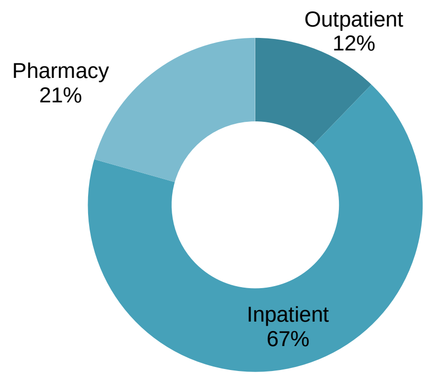


Fig. 48 (B): Segment-wise gross profit breakdown, 2012



Sources: Company reports, Saudi Fransi Capital analysis; Distribution and medical and drug equipment segment reported loss of SAR 64,482

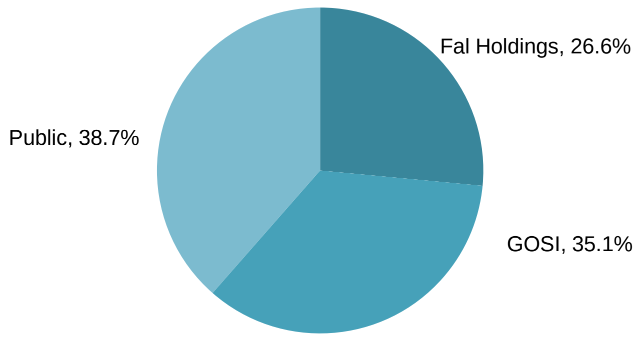
Revenue increased at a CAGR of 15.0% over 2008-12 supported by impressive growth across segments

Care's revenue rose at a CAGR of 15.0% during 2008–12, benefitting from improvement in healthcare services, which has led to significant increase in the number of patients visiting hospitals in KSA. Advancement in diagnostics and treatments has resulted in 17.1% growth in inpatient revenue, whereas availability of better services has led to 8.6% rise in outpatient revenue. Revenue from the pharmacy segment has increased at a CAGR of 9.5% during 2008–12 due to rising prescription sales. PMD has also benefitted from growing demand, with revenue reaching SAR 15mn in 2012 compared with SAR 3mn in 2011. Increase in the share of high-priced inpatient segment and greater offering in higher margin specialization resulted in an impressive 42% growth in operating income as revenue increased at a faster pace compared to expenses over the same period. Net income also increased at a CAGR of 41% during the same period.

Shareholder structure

Care's major shareholders include General Organization for Social Insurance (GOSI) (35%) and Fal Holdings (27%).

Fig. 49: Shareholder structure



Sources: Tadawul, Saudi Fransi Capital analysis

National Medical Care Company

Management details

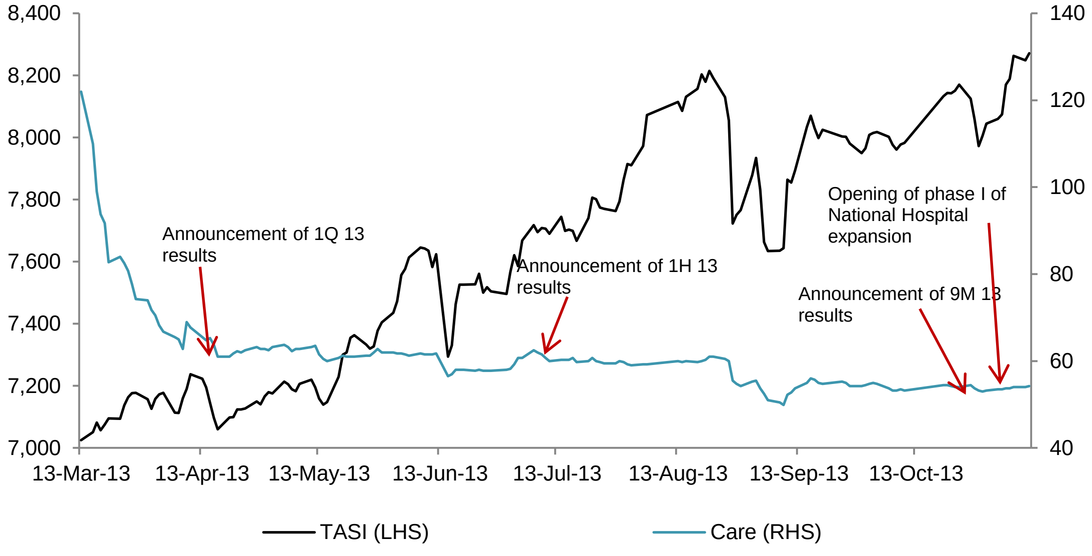
Fig. 50: Key management and board members

Eng. Abdullah Mohammed Al Isa	Chairman
Mr. Bader Fahad Al Athel	Board Member
Mr. Adeeb Abdulrahman Al Sowaillim	Board Member
Mr. Abdulaziz Saif Al Saif	Board Member
Eng. Adel Mohammed Al Krashe	Board Member
Dr. Shuwaimi Huwaimel Al Fowiz	Board Member
Mr. Yasser Sagr Al Otaibi	Board Member
Dr. Yazeed Abdulrahman Al Ohaly	Board Member
Mr. Abdulmajid Abdullah Al Mubarak	Board Member

Sources: Tadawul, Saudi Fransi Capital analysis

Stock price performance

Fig. 51: Care price Vs TASI



Sources: Tadawul, Saudi Fransi Capital analysis

3Q 2013 results

In its 3Q 2013 results announced on October 27, 2013, Care reported a 13% YoY decline in earnings which reached SAR 18.8mn, 6.9% below consensus estimates. Revenue increased 11% YoY backed by stronger growth in patient visits to the hospital. However, higher operating expenses incurred by Care as a part of its expansion initiatives pressurized operating profits, and hence net profits. The QoQ performance was affected by lower inpatient and outpatient visits during the Ramadan and summer vacation which resulted in decline in revenue.

Fig. 52: Result snapshot

In SAR mn, unless specified	3Q 2012	2Q 2013	3Q 2013	QoQ change	YoY change
Revenue	121.0	142.2	134.6	(5.4%)	11%
Gross profit	28.8	28.8	24.1	(16.3%)	(16%)
Gross margin (%)	23.8	20.3	17.9		
Operating profit	21.6	21.6	17.4	(19.4%)	(19%)
Operating margin (%)	17.9	15.2	12.9		
Net income	21.5	22.2	18.8	(15.3%)	(13%)

Sources: Tadawul, Saudi Fransi Capital analysis

Valuation Analysis

Target price at SAR 56/share; recommendation: HOLD

We valued Care using a combination of fundamental and relative valuation techniques. For fundamental valuation, we used the discounted cash flow (DCF) method. For relative valuation, we relied on price-to-earnings, and enterprise value-to-EBITDA multiples.

Fig. 53: Blended valuation

	Target price	Weights
DCF valuation	**56.7**	**50%**
EV/EBITDA multiple	**53.8**	**25%**
P/E multiple	**55.7**	**25%**
Weighted average target price	**55.7**	
Upside/downside from current market price	*2.8*	

Source: Saudi Fransi Capital analysis

DCF valuation

Our DCF model is based on a five-year explicit forecast period from 2013 to 2018. DCF valuation yielded a fundamental value of SAR 56.7/share. The company's consolidated DCF is presented in the table below.

Fig. 54: Discounted cash flow valuation summary

In SAR mn	2013e	2014e	2015e	2016e	2017e	2018e
EBIT * (1-t)	95,617	126,045	157,091	186,270	222,061	259,210
Add: Depreciation and amortization	38,839	32,613	36,206	37,814	39,518	41,496
Changes in working capital	(17,045)	(58,104)	(17,225)	(16,057)	(13,746)	(11,963)
Capital expenditure	(216,640)	(63,675)	(68,727)	(53,588)	(56,812)	(65,931)
Free Cash flow to Equity	**(99,230)**	**36,879**	**107,345**	**154,439**	**191,022**	**222,812**
Present value of the free cash flow	(98,224)	32,923	86,426	112,109	125,057	131,555
Terminal value						3,367,667
PV of future cash flows						488,070
PV of terminal value						1,988,380
Total Enterprise Value						**2,476,450**
Add: Cash & equivalents						206,092
Less: Debt						90,630
Less: Other liabilities						49,374
Equity value						**2,542,537**
Number of shares (mn)						44,850
Target price per share						**SAR 56.7**

Source: Saudi Fransi Capital analysis

Valuation is sensitive to WACC and Terminal growth rate

Our DCF valuation is based on WACC of 10.9% and a long-term growth rate of 4.0%. The derived WACC is based on cost of equity of 11.1% and post-tax cost of debt of 5.6%. For the valuation, we calculated WACC assuming an equity-to-debt ratio of 96-to-4.

Fig. 55: Sensitivity to WACC and terminal growth rate assumptions

		Terminal growth rate				
		2.0%	3.0%	4.0%	5.0%	6.0%
WACC	8.9%	60.8	69.5	81.7	100.2	131.5
	9.9%	52.5	58.7	67.0	78.8	96.6
	10.9%	46.0	50.7	56.7	64.7	76.1
	11.9%	40.9	44.5	49.0	54.8	62.5
	12.9%	36.8	39.6	43.0	47.4	52.9

Source: Saudi Fransi Capital analysis

Relative valuation

Care is trading at 2014 P/E and EV/EBITDA multiples of 18.0x and 14.3x (respectively)

For the market approach-based relative valuation of Care, we used P/E and EV/EBITDA multiples, which we believe are most suited for this purpose. We selected a peer group of healthcare service providers that operate within GCC, the Middle East, and Africa (MEA) as well as global healthcare providers. We believe in view of no strategic expansion plans Care lacks any significant catalyst for growth in the long-run. However, possible scope for improvement in margins is the major driver for earnings in future. Thus, on a conservative note, we expect Care to trade in line with its KSA peer group. We have assigned target P/E and EV/EBITDA multiples of 18.4x and 14x, respectively to Care. Our comparative valuation is summarized in the following table.

Fig. 56: Relative valuation

	Market Cap (USD mn)	Price/Earnings (x)			EV/ EBITDA (x)		
Company		**2012**	**2013E**	**2014E**	**2012**	**2013E**	**2014E**
Care Health	**652**	**23.3**	**23.2**	**18.0**	**18.2**	**16.9**	**14.3**
Dallah	850	23.9	25.6	18.5	16.5	18.9	13.7
Mouwasat	1,147	25.1	22.4	18.2	19.5	17.4	14.2
Medicare Group	423	22.4	NA	NA	14.2	NA	NA
NMC Health PLC	1,197	9.3	17.5	16.8	7.8	13.8	12.4
Life Healthcare Group	4,086	22.6	23.6	20.4	12.8	13.3	11.8
Netcare	3,527	18.8	17.6	14.9	10.6	10.6	9.9
Fortis Healthcare	781	64.0	8.3	NA	21.1	12.0	22.9
Bangkok Chain Hospital PCL	495	19.7	24.1	20.4	12.9	14.2	12.4
Ramsay Health care Ltd	7,218	20.1	28.9	24.9	11.0	14.5	12.8
MCap weighted average multiple for Saudi Arabia (Ex- Care)		**24.6**	**23.8**	**18.4**	**18.2**	**18.0**	**14.0**
MCap weighted average multiple for GCC		**20.3**	**20.2**	**17.2**	**12.6**	**12.9**	**11.2**
MCap weighted average multiple for MEA		**21.9**	**23.0**	**19.4**	**12.4**	**13.4**	**12.3**

Sources: Bloomberg, Saudi Fransi Capital analysis

Forecast Assumptions

Optimum utilization of existing operations to aid revenue expansion

High utilization rates at hospitals to result in 13.8% CAGR growth over the forecast period

We forecast Care to report 13.8% CAGR growth in revenue over 2012-18 supported by effective utilization of its existing capacities and ability to maintain high price per patient on account of its specialized services. Based on our discussion with management, we believe the current expansion plan of adding 200 beds to the Riyadh National Hospital has already become operational. The company inaugurated soft launch of the new capacity in November which will extend for another six months. We have assumed commercial operations of the new capacity to begin adding to the revenue and earnings from 2Q 2014. Post the addition of these new beds Care's total bed capacity is likely to increase from current 420 to 620 in 2014. Additionally, we believe out of the four family centers that the company plans to open, two are expected to be operational in early 2014. While there are no other potential expansions planned for future, we expect Care to optimally utilize its bed capacity and expect its utilization levels to reach above 85% on an average. This coupled with high average price per patient is expected to result in revenue rising from SAR 525mn in 2012 to SAR 1,137mn in 2018.

In view of lack of data on the number of clinics we have forecasted outpatient revenue based on the number of doctors and patient visiting each day. We assumed each clinic would operate 360 and each doctor would treat about 10 patients. We have assumed average stay of 6 days for forecasting the inpatient department revenue over the forecast period.

Fig. 57: Revenue

In SAR mn	2012	2013E	2014E	2015E	2016E	2017E	2018E
Total revenue	**525**	**576**	**674**	**757**	**858**	**980**	**1,137**
YoY growth		*9.8%*	*16.9%*	*12.4%*	*13.3%*	*14.1%*	*16.1%*
Inpatient							
Revenue	342	346	404	468	549	648	782
YoY growth		*1.1%*	*16.7%*	*16.0%*	*17.2%*	*18.1%*	*20.6%*
Inpatient Capacity (beds)	420	420	620	620	620	620	620
Outpatient							
Revenue	**62**	**68**	**99**	**109**	**120**	**132**	**145**
YoY growth		*10.8%*	*44.8%*	*10.3%*	*10.1%*	*10.0%*	*9.9%*
Pharmacy							
Revenue	106	109	113	118	122	127	132
YoY growth		*3.4%*	*3.8%*	*3.8%*	*3.8%*	*3.8%*	*3.8%*
Distribution of medical drug and equipment							
Revenue	15	52	57	62	67	72	78
YoY growth		*249.0%*	*9.5%*	*8.0%*	*8.0%*	*8.0%*	*8.0%*

Source: Saudi Fransi Capital analysis

In 2012, Care's inpatient segment is the major contributor to revenue and accounts for 65% of the share. While outpatient segment accounts for 12% of total revenue, pharmacy and distribution of medical drug and equipment contributed 20% and 3%, respectively. We expect inpatient revenue to grow at a CAGR of 14.8% over 2012-18 benefiting from increase in the patient visits and rise in surgeries and other medical activities. Outpatient revenue is expected to grow 15.3% over the same period as the patient footfall increase. Furthermore, while pharmacy revenue is expected to grow 3.7%, relatively new medical drug and equipment revenue are estimated to grow at a CAGR of 31.6% over 2012-18. While we expect the inpatient segment's share of total revenue to

reach 69% by 2018, outpatients is expected to be 13%. Contribution from the Pharmacy and distribution of medical drug and equipment segments to total revenue is expected to be 12% and 7%, respectively.

Margins to report healthy growth during 2012–18E owing to efficiency in operations

Operating margins to reach 24.4% by 2018 from 19.8% in 2012

We expect operating margins to improve 460bps to reach 24.4% in 2018 from 19.8% in 2012 as a result of operational efficiency due to hospitals operating at high utilization levels as well as high pricing. We expect, at high utilization levels of above 80%, there is significant scope for Care to benefit from economies of scale in terms of reduced direct costs, lower administrative and selling and distribution expenses. Over the forecast period we expect Care' s direct cost to total revenue to reduce to c.71% in 2018 compared to c.74% in 2012. In addition, due to absence of any significant expansion plan, we believe the company's expenditure on other administrative issues as well as advertising and promotion to be limited. As a result, in 2018, we are anticipating these expenses to decline to 4.8% as a percentage of sales.

We estimate Care's net profit to expand at a CAGR of 17.5% to reach SAR 277mn in 2018. We assume an effective tax rate of 5.7% during the forecast period, in line with the current trend.

Fig. 58: Gross and net profits

In SAR mn	2012	2013E	2014E	2015E	2016E	2017E	2018E
Gross profit	**135**	**131**	**167**	**204**	**241**	**285**	**332**
YoY growth		*-3.2%*	*27.9%*	*22.3%*	*17.6%*	*18.3%*	*16.6%*
Gross margin	*25.8%*	*22.7%*	*24.8%*	*27.0%*	*28.0%*	*29.1%*	*29.2%*
Operating profit	**104**	**102**	**135**	**168**	**199**	**238**	**278**
YoY growth		*-1.6%*	*31.8%*	*24.6%*	*18.6%*	*19.2%*	*16.7%*
Operating margin	*19.8%*	*17.8%*	*20.0%*	*22.2%*	*23.2%*	*24.3%*	*24.4%*
Net profit	**105**	**105**	**136**	**169**	**199**	**237**	**277**
YoY growth		*0.4%*	*29.2%*	*23.8%*	*18.3%*	*18.9%*	*16.7%*
Net margin	*20.0%*	*18.3%*	*20.2%*	*22.3%*	*23.2%*	*24.2%*	*24.3%*

Source: Saudi Fransi Capital analysis

Debt levels and capital expenditure

Care incurred capital expenditure of SAR 643.4mn for capacity expansion and development of family center

Based on the company's prospectus details, we believe the company incurred capital expenditure of SAR 545mn on the expansion of Riyadh Hospital's bed capacity which it expects to finance through its IPO proceeds. In addition, the company also expects to incur SAR 98.4mn for the development of four family healthcare center as a part of its expansion plans that will be also financed through IPO proceeds. We believe, in view of absence of any significant capacity expansion plans over the future years, we believe Care's strong earnings coupled with falling debt levels will strengthen its cash position that could be utilized for any of its future inorganic growth initiatives.

Dividend payment

We expect Care to maintain a dividend payout ratio of approximately 60% over the forecast period. Dividend yields would remain in the range of 2.7–7%.

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Income Statement (in SAR mn)	2009	2010	2011	2012	2013E	2014E	2015E
Revenues	**374**	**426**	**458**	**525**	**576**	**674**	**757**
Direct costs	(298)	(322)	(337)	(390)	(445)	(506)	(553)
Gross profit	76	104	121	135	131	167	204
Operating expenses	(21)	(22)	(26)	(31)	(28)	(32)	(36)
Operating income	55	82	95	104	102	135	168
EBITDA	78	107	122	132	141	168	205
Finance charges, net of Other income	6	8	6	7	9	9	11
Net income before Zakat	61	91	101	111	112	144	179
Zakat	(4)	(6)	(6)	(6)	(6)	(8)	(10)
Net income for the year	**57**	**85**	**95**	**105**	**105**	**136**	**169**
EPS (SR)	1.26	1.89	2.11	2.34	2.35	3.04	3.76
Balance sheet (in SAR mn)							
Cash and cash equivalents	58	112	90	72	305	222	129
Accounts receivable and prepayments	152	142	201	228	253	333	369
Inventories	18	24	28	35	44	57	56
Total current assets	**228**	**278**	**318**	**335**	**602**	**612**	**554**
Non-current assets	294	329	367	459	637	679	723
Total assets	**522**	**606**	**685**	**795**	**1,240**	**1,291**	**1,276**
Accounts payable, accruals and Zakat provisions	67	79	89	107	123	162	182
Total debt	0	0	0	32	245	183	75
End of services indemnities	38	41	43	46	46	69	77
Total liabilities	**105**	**119**	**132**	**185**	**415**	**414**	**335**
Shareholders' equity	417	487	553	610	825	877	942
Total liabilities and shareholders' equity	**522**	**606**	**685**	**795**	**1,240**	**1,291**	**1,276**
Cash flow (SAR mn)							
Net cash from operating activities	67	129	70	119	127	137	200
Purchase of property and equipment	(65)	(60)	(64)	(121)	(217)	(74)	(81)
Net cash used in investing activities	(55)	(60)	(65)	(121)	(217)	(74)	(81)
Debt	0	0	0	32	213	(62)	(108)
Dividend paid	0	(15)	(29)	(48)	(65)	(84)	(104)
Increase in capital	0	0	0	0	175	0	0
Net cash from (used in) financing activities	0	(15)	(29)	(16)	323	(146)	(212)
Net change in cash and cash equivalents	**12**	**55**	**(23)**	**(18)**	**233**	**(83)**	**(93)**
Cash & cash equivalents at the beginning of the period	45	58	112	90	72	305	222
Cash & cash equivalents at the end of the period	**58**	**112**	**90**	**72**	**305**	**222**	**129**

Sources: Company reported and Saudi Fransi Capital analysis

Recommendation Framework

BUY: The analyst recommends a BUY when our fair value estimate is at least 10% higher than the current share price.

HOLD: The analyst recommends a HOLD when our fair value estimate ranges within ±10% of the current share price.

SELL: The analyst recommends a SELL when our fair value estimate is lower by more than 10% from the current share price.

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